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The Demutualisation of Building Societies: A Contextual Analysis of the Changing Nature of Mutuality

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Lorraine Talbot

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Abstract

The contention of this thesis is that the demutualisation of building societies may be understood as resulting from the process of reconceptualisation that mutuality has undergone throughout its history. It is suggested that the history of mutuality is the history of the tendency towards its own destruction as building societies evolved from small local concerns into being some of the largest financial institutions in the national economy. Further to this, it is suggested that observation of the nature of mutuality at various historical moments provides insights into the nature of building societies per se. Furthermore, the nature of mutuality at any historical moment reflects the contextual forces that prevail upon it. In other words, mutuality provides an index to the political, social and economic forces at a particular moment in history and understanding mutuality in this way provides a framework in which to understand future developments in mutual building societies.

In support of this hypothesis, this thesis demonstrates that mutuality in the context of early building societies denoted equality between members in respect of rights, responsibilities and benefits. Mutuality *meant* equality, responsibility and benefits and the concept described actual material relations. However, when building societies became widespread and highly capitalized, policy and legislation combined to construct a mutuality that created a manageable financial institution for the wealthier working classes and lower middle classes. Mutuality denoted the political imperative to encourage thrift and property ownership within a legislative framework and it was characterized by the separation of the borrower- member role from the lender-member role and the formal creation of a legal entity, the incorporated building society.

By drawing upon distinct historical periods, this thesis contends that this hybrid commercial organization, the mutual building society, is to a great extent the creature of government policy, which is central to the construction or destruction of mutuality. This is particularly evident in the politics that informed the passage of the 1986 Building Societies Act, which provides for conversion or demutualisation. However, as this thesis demonstrates, mutuality reflects the internal character of building societies such as the relationship of the membership to the society, and external factors, such as the political and economic climate. Thus, the maintenance of mutuality will depend on the interplay between these factors.

Contents

Chapter 1
Introduction

In *Grundisse*, Marx set out his method for analysing the political and economic character of society. [1] This method, described in the context of a critique of the Hegelian dialectical method, is a partial adoption and a modification of this investigative approach. Like Hegel, Marx viewed the whole of reality as a single historical process and adopted Hegel's dialectical method. Yet crucially, Marx connected that which the analysing mind concluded, with real, tangible phenomena and thus distinguished his approach from Hegel's internal journey of the mind. That is, for Marx, the experience of the analysing mind is an experience initially derived from real tangible phenomena. In contrast, Hegel attributed the conclusion of the mind to the creative act of the mind alone. The method that Marx developed from Hegel's dialectics, Marx called dialectical materialism, a dialectical method for the study of material factors.

As a method for comprehending society and phenomena within society, dialectical materialism begins with a living whole, such as the population and the state. It then attempts to distil simple but determining features of this society, 'determinate, abstract, general relations such as division of labour, money, value'[2] and from that point draws out the connection between these latter

[1] Marx, K (1973) "Grundisse, Foundations of the Critique of the Political Economy (Rough Draft)" Penguin
[2] ibid p99

‘simple relations’ and the establishment of economic systems.[3] Simple relations such as labour and exchange are crucial components of the accompanying economic system. The economy is accommodated and protected by a political system which it spawns and which modifies its activities. The living whole, (individuals, state and economy), is the amalgamation of many diverse and contrary simple factors; it is a concrete whole but perversely. ‘a unity of the diverse’.[4]

It is the co-existence of the diverse that, in dialectical method, accounts for motion and change. A concrete whole consists of contradictory phenomena which contain the seeds of their own destruction and the dynamic for the emergence of the new. For Hegel, the dialectic described the development of the idea, an intellectual journey that would lead to perfect knowledge and, therefore, absolute freedom. The process by which history embodies the dialectical development of the spirit (or Geist) is that of the movement from thesis to antithesis and then to synthesis. An historical point (thesis) gives rise to counteraction (antithesis) and the merging of these two points give rise to a synthesis, a higher stage of history and therefore Geist. This synthesis then exists as the new thesis which give rise to the counter-reaction and the whole process begins again.

In contrast to Hegel, Marx argued that a conception of the concrete whole, at any historical stage, is reached by observation and analysis of real observable phenomenon in their most simple and abstract form.

> The method of rising from the abstract to the concrete is the only way in which thought appropriates the concrete and reproduces it as concrete in the mind. [5]

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[3] ibid p100
[4] ibid
[5] ibid p101

And, unlike Hegel he argued that 'this (thought or Geist) is by no means the process by which the concrete itself comes into being'.[6]

By way of illustration, Marx observed that even simple abstractions such as exchange value could not exist outside a population producing within particular set of social relations and situated within a particular kind of family and under a particular kind of state. In other words even a simple abstract, though understood and contained in the mind, cannot actually exist and therefore be available for comprehension, outside the actual existence of a material whole.

Furthermore, although it is possible to observe simple categories existing as a long- standing historical phenomena in highly diverse concrete wholes, the character of these categories differ according to their historical context. Marx notes, for example, that money existed in antiquity, and therefore historically preceded the existence of capital, banks or wage labour. However, although money was present in both societies, within the concrete whole of Greek and Roman society, money was not understood in the same way. In a developed market economy, money expresses the value of all commodity exchanges whilst existing as a commodity in its own right. In the economies of antiquity, money did not represent the value of all exchanges and was only really utilised for the payment of the army because its personnel were drawn from many diverse and semi-conquered peoples who traveled extensively in pursuance of their duties. Here, money was required as a symbol of payment that was transferable in the diverse places they traveled or returned. In contrast to this practice, the settled townspeople of Roman society engaged mainly in transactions that were paid in kind. [7] And, although there was some exchange and lending in

[6] ibid
[7] ibid p103

coinage, this practice was understood to be anti-social and destructive. Money should not be worth more when repaid than it did when it was lent as this undermined its function as a fair expression of value causing disharmony in the exchange of goods and services.

Likewise, in less developed agricultural societies, trading and money transactions tended to be subordinate to barter and class determined rewards. This approach to money reflected the dominant character of a feudal hierarchy which overarched agricultural production and in which abstract value such as money was not generally appropriate. So, for example, in early mercantile England, where commodity exchange still represented a fledgling portion of the economy, the idea of money being a commodity was almost unnatural. So, although money- lenders did operate in mercantile England, making money from the temporary gifting of sums to their customers, their activities were not generalised, normalised or condoned. On the contrary, money- lenders were reviled as usurers and, notwithstanding a period of relaxation during the Elizabethan period, (where interest of up to 10% could be charged), usury was considered an immoral and illegal act. In Britain, the usury laws were not repealed in their entirety until 1858 and contravention of these would make a man, 'liable under the statute of usury and liable to forfeit three times his capital'.[8] Furthermore, even during the aforementioned time of relaxation, Shakespeare famously characterised public attitudes to money- lenders (and therefore Semites), in The Merchant of Venice. So, in the words of English literature's most famous money- lender, Shylock,

> You call me misbeliever, cut-throat dog ,
> and spit on my Jewish gaberdine,
> And all for use of that which is mine own [9]

[8] The Cornish Metal Company (1787) quoted in Armand Du Bois.(1938) "The English Business Company after the Bubble Act " New York Commonwealth Fund p257 note 65
[9] William Shakespeare "The Merchant of Venice" Act 1 Scene 3 line 106-8

It was not until the development of the bourgeois economy, born from the womb of feudalism, that capital was placed at the centre of economic activities. In the context of this new market economy, money- lending was no longer reviled but considered a desirable and respectable activity, to be performed in the main, by upstanding financial institutions. The movement of capital within particular exchange relations of the new economy, from purchaser to vendor or from lender to debtor (with interest), was both normalized and generalized. In other words, money, as a generalized system and as a commodity with an exchange value, did not emerge until the concrete conditions of a more developed society existed.

Thus, the dialectical method of historical materialism shows how a single element of a society can both describe the norms of that society and, in turn, may alter its own internal meaning according to its position in an existing concrete whole. Like money, mutuality is a concept that existed and exists within a particular historical period and which displays characteristics that describe the norms of that period. So, when the concrete whole in which mutuality exists, changes, so too does the meaning of mutuality. And, conversely, mutuality will affect the context in which it finds itself, that is, within building societies operating as part of the concrete whole. Historical materialism, therefore, is adopted in this thesis as the most appropriate method of understanding the changing nature of mutuality and the manner in which mutuality has simultaneously affected the concrete whole.

Mutuality and Dialectics.

Mutuality is a term that has been attributed, (descriptively and then prescriptively in statute), to the organisational form taken by building societies since their emergence in the late eighteenth century. Early building societies operated along mutual, egalitarian principles that gradually deteriorated in the last part of the nineteenth century. So pronounced was this deterioration that two hundred years later, in the 1990s, the concept of mutuality retained so little positive meaning for building society members that they only became aware that their building society was a *mutual* society when voting to eradicate mutuality. The apparent invisibility of mutuality in building societies led many commentators in the latter part of the twentieth century to assert that mutuality no longer existed. For example, in *The Myth of Mutuality*, the author, Paul Barnes, argued that mutuality was a fiction and a fraud. For Barnes, mutuality no longer existed in building societies, largely because the power wielded by management had eradicated any meaningful exercise of democracy by its members. [10]

It is the contention of this thesis that this assessment overstates the case against the existence of mutuality. Rather, it maintains that mutuality has changed in response to particular historical developments which have modified but have not eradicated its classic characteristics. It further contends that by using the method of historical materialism, it is possible to analyse those historical factors that have shaped and continue to shape the meaning of mutuality.

The mutuality of building societies originated in the context of the social and material needs of the newly emerging working class who were landless, but possessed some financial means.

[10] Paul Barnes (1984) "The Myth of Mutuality" Pluto Press

Furthermore, mutuality arose in a period of heightened political change and shifting allegiances.

The gradual transformation of the economy from agricultural production to commodity production was accelerated by the passage of hundreds of enclosure Acts at the end of the eighteenth century which extinguished the long held rights in land held by members of the community. From 1761 to 1780 over a thousand such Acts were passed with a further nine hundred passed from 1781-1800. [11] Furthermore, between 1793-1813, 2,260,000 acres of land were put into cultivation following the passage of 1,883 Acts. [12] This had the obvious effect of creating a landless labour force on the one hand, and on the other, the concept that land was a commodity, the title to which could be owned privately. In a dramatic surge of change, the labourer was transformed into an individual who no longer worked according to the duty owed to his political superior, but one who privately 'owned' his ability to work.

The feudal social hierarchy that largely determined status, work and reward was, with the emergence of the market system of production, replaced by the notion that work was a commodity that could be exchanged like any other commodity by the individual who 'owned' it. In the absence of slavery, (for slavery continued to operate in the British colonies among white as well as black people), this particular commodity was owned by the individual that actually performed the activity.[13] Thus, the worker could exchange his property for a reward that was, at least in theory, negotiated by himself and the individual who wished to purchase it. With that transaction completed, the worker could then exchange the negotiated value of his work for other commodities that he required or desired. And, with the emergence of land as a commodity that

[11] Halevy, (1924) "The History of the English People" 1815, p261
[12] ibid
[13] Zinn (1999) "A People's History of the United States" Longman

could be purchased, that desired commodity could be a home. So, it was these factors that presented the initial and crucial context for the emergence of mutuality and represented material changes in the English economy.

Related to these factors were the diverse ideologies that legitimated this method of economic organisation and those that modified it. In other words, the dialectical relationship between the ideology of the old system, feudalism, and the ideology of the new market system were factors in constructing mutuality. The philosophy of the old system was connected to the ideas of conservatism whilst the philosophy of the new was connected to the ideas of liberalism. The ideas of conservatism, unlike those of liberalism did not have a set of formal philosophers to articulate them[14] but it is possible to understand conservatism as a set of ideas through the writing and speeches of conservative politicians. Foremost in this group was Whig politician Edmund Burke whose treatise against the French revolution insisted upon the need for social hierarchy and strong Government continuing the trajectory defined by classic Greek philosophy.[15] The classical thinkers, from Aristotle to Plato believed that society existed as a predetermined fact based on the natural hierarchy of individuals. For Aristotle hierarchy was articulated mainly in terms of the humours, an ideology of which legitimated women's inferiority to men. Men were supposedly possessed of dry hot (superior) humours whereas women possessed cool, damp (inferior) humours. And these notions explained the external nature of male genitalia and the internal nature of female genitalia, the latter being merely inverse male organs that had insufficient 'heat' to externalise.[16]

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[14] Thomas Hobbes has been claimed as a conservative philosopher for his emphasis on the need for a strong 'Leviathan' state. He has also been claimed as a liberal thinker for his emphasis on individual 'natural' attributes.

[15] Edmund Burke (1790) "Reflections of the Revolution in France" Owen: London

[16] Aristotle (1990) "The Works of Aristotle" Chicago press

These ideological quasi- biological notions continued in English thinking until the rise of science and rationalism. For example, a pregnancy resulting from an alleged rape would disbar any action by the alleged victim. This was because a woman, understood to be an inverse man, produced her 'seed' upon pleasurable ejaculation, like a man. Pregnancy required the female seed and thus orgasm therefore the copulation must have been pleasurable and could not have been forced, a view of conception that continued until science better understood human ovulation.

For Plato, hierarchy was understood in terms of the 'metal' of the individual's soul, the purest 'metal' being possessed by the philosophers who strove to understand the truth and therefore understand the divine; the meanest metal being possessed by artists, who sought merely to reproduce, in a useless form, that which already existed in a useful form.[17] Thus, for the philosophy of Plato, Aristotle, and the conservative thinking that it informed, society was an organic whole, composed of inferior and superior beings. Social order, a state where humanity could be productive and creative, resulted from an acceptance and enforcement of the natural hierarchy; be that between men and women, *Philosopher King* and artist or rich and poor. For the conservative thinker, failure to observe this natural order would result in brutality and social destruction.

This way of understanding social reality served admirably to legitimize the fixed social hierarchy of feudalism that underpinned England's agricultural economy. Individuals were born into a particular social strata in which they remained until death, generation after generation *ad infinitum*. Social stratification determined rights in the land, duties to superiors, responsibilities

[17] Plato (1984) The Republic: Second Edition (revised) Penguin Books

to inferiors and familial reward. Social mobility was virtually non- existent, thus, questions such as 'what will I be', and 'who am I', were irrelevant for the ordinary person. The church and state edited the bible to emphasise hierarchy rather than equality, exemplified in such hymns as, *All things bright and beautiful,* whose Christian message outlined a hierarchically organized world. Everything had a place in creation. God, himself had rubber stamped inequality, extending from the lowliest animal to hierarchy in the human social world, as the song goes,

> The rich man in his castle, the poor man at his gate,
> He made them high and lowly and each to his estate.[18]

However, this understanding of social reality could not describe or legitimize the new burgeoning market economy. As one writer put it,

> Exchange, or the circulation of commodities, is predicated on the mutual recognition of one another as owners by those engaged in exchange. This acknowledgment, appearing in the form of an inner conviction or of the categorical imperative, is the maximum conceivable height to which commodity-producing society can rise. But in addition to this maximum to be realised, it is sufficient for commodity owners to act as if they acknowledged one another mutually as proprietors. Moral conduct here is contrasted with legal conduct, which is characterised as such irrespective of the motive which generated it. [19]

So, in contrast to conservatism, liberal ontology placed the individual before society. For the liberal, society was merely the decision of an amalgamation of separate autonomous individuals to come together in order to pursue individual self- interest. The form that society took was not a given fact and certainly not divinely ordained but depended upon a series of decisions that private but pragmatic individuals had taken. A dynamic society was one that properly reflected the will of individuals and that could not occur unless those individuals were free to make

[18] "All Things Bright and Beautiful"
[19] Pashukanis, EB (1989) "Law and Marxism" p162 Pluto Press

choices. Thus, liberal thought tended to stand for social equality and freedom of expression coupled with personal responsibility for those decisions, and society was understood as a market for the exchange of freely made material choices.

Legally, the responsibilities of individualism and the absence of morality outside the values individuals choose to adopt, were, and are, most readily reflected in modern contract law. In a world of autonomous individuals engaging in exchange relationships of their own choosing, contract personified the new role of the state in liberal, market capitalism. The state's role in the liberal view is essentially that of enforcer of agreements made between 'free' individuals vigorously pursuing their own interests and desires, rather than one of enforcing hierarchy and social order.

In his classic book, P.S. Atiyah traces the connection between liberalism, the free market and contract.[20] He argues that it was liberal notions of autonomy and personal responsibility that provided the philosophical rationale for the courts' re-conceptualisation of contract in nineteenth- century England. According to Atiyah, during the period between 1770-1870, liberal values and ideas shaped the law's attitude to the making of contracts. Judgments assumed that all consequences of a contract were the product of the will of the parties, so the courts would not intervene if the parties had made a bad bargain and would not consider the possibility or consequences of inequality of bargaining power between the parties. In contrast, the courts' attitude to the making of agreements in the eighteenth century emphasised and actively imposed a standard of fairness based upon custom. The law and the courts, (usually in the form of lay justices) would actively intervene and void or amend contracts on a wide variety of grounds.

[20] PS Atiyah (1979) "Rise and Fall of the Freedom of Contract" Clarendon Press. Oxford

Connected to this nineteenth century move away from substantive ideas of fairness, Atiyah notes a growing hostility to the ideas of equity. The rationale behind this was that obligations imposed by the law should not take precedence over obligations voluntarily entered into by the formally equal individuals of a liberal world. The rise of contract as the leading form of legal relations between individuals also accounts for the change in form of the contract itself and the most dramatic change was, in Atiyah's words, 'the rise of the executory contract'; that is the emergence of a legally enforceable document based purely upon the future promises and intentions of the relevant parties. In contrast to the types of contracts that courts would enforce in the eighteenth century, that is contracts that had been performed by at least one of the parties, nineteenth century courts began to enforce contracts where no consideration had been received or provided by either party. The mere exchange of promises was sufficient to make a legally binding agreement and the same rules that were applied to executed contracts were also applied to executory contracts. The bilateral executory contract with its conceptual basis in 'offer, acceptance and consideration' that now characterises most twentieth century contractual arrangements, emerged as a nineteenth century phenomenon. The intentions of autonomous individuals were elevated to such an extent that the mere exchange of promises became a piece of property in itself. Refusal to perform a promise could result in the payment of expectation damages in the same way that damages were payable on the one- sided exchange of consideration in the eighteenth century.

Another striking consequence of the growing individualism of contract law was the dilution of certain rules applicable to contracts, namely rules relating to duress, mistake and frustration. For example, in contrast to the previous period, nineteenth century courts would not void a contract on the basis of, 'economic duress'. Liberal individualism was antagonistic to the notion that autonomous, equal individuals could be forced into a legal agreement through economic necessity, as formal equality and volition were assumed. Likewise, the eighteenth century notion of 'mistake' was insufficient grounds to void a contract. It was assumed that contracting parties were the best placed to determine whether or not it was to their personal advantage to make the bargain. The making of a bad bargain was the responsibility of the individual, not the courts; hence the classically liberal phrase, *caveat emptor* (let the buyer beware). Even in contemporary contract law, an era Atiyah characterises as, 'the fall of the freedom of contract', the rules pertaining to mistake remain strict. A contract may be void by mistake if, in the case of mutual mistake, 'a mistake by both parties to the contract renders the subject matter of the contract essentially and radically different from that which both parties believed to exist at the time the contract was executed, the party seeking to rely on mistake must have reasonable grounds for believing the mistake.' [21] Atiyah concludes that in keeping with rule of law ideology, nineteenth century courts adopted a formal non-interventionist stance to the making of contracts, a stance radically divorced from the moral notions of eighteenth century England.

Freedom of contract and freedom to contract was essential for the development of the new market economy and liberalism defended this freedom by providing it with a philosophical rationale and ideological justification. But the market, with its requirement for freely contracting individuals, conflicted with many of the norms of the feudal hierarchy from which it arose. Market ideology conflicted with feudal ideology. It was in the context of this conflict that building societies emerged. In an time of acute conflict between the old and the new society building societies become the products of, and to a certain extent architects of, the conflicts and resolutions that ensued. As chapter 1 of this thesis indicates, conservative thinkers under Pitt, sought, and for the most part obtained, strict anti-collective legislation. Politicians such as

[21] Associated Japanese Bank v Credit du Nord [1988] 3 AER 962

Edmund Burke, eloquently described the social chaos that would ensue if individual desire triumphed over a fixed hierarchical social order. Accordingly, organised collectives seeking social change were something to be feared and repressed and the social equality explained as a universal right by Thomas Paine, (writing in response to Burke's own *Reflections on the French Revolution*), was the first step to anarchy. In this context, Paine's practical entreaties to seize the potential of that point in history, to address the question of;

> whether man shall inherit his rights, and universal civilisation take place? Whether the fruits of his labour shall be enjoyed by himself, or consumed by the profligacy of governments? Whether robbery shall be banished from courts and wretchedness from countries? [22]

were dismissed as pandering to a mob mentality. Likewise, conservative criticisms of equality and freedom were prosaically expressed in the philosophical writings of Donatien-Alphonse-Francois de Sade, who offered a stark insight into contemporary critics of early liberal individualism. Writing in eighteenth century France, the Marquis echoed the sentiments of English philosopher Thomas Hobbes, published over a century before. In de Sade's brutal, erotic world, his fictitious characters show that the unfettered individual, will commit any manner of atrocity in order to satisfy desire and that the absence of state interference in the life of the individual induces a reversion to animalism. Accordingly, as it is only social conventions such as morality which make murder or rape into crimes; a world without such conventions would degenerate into brutality In the words of de Sade's 'libertine' hero Dolmance in instruction

[22] Thomas Paine (1792) "Rights of Man, being an Answer to Mr Burke's Attack on the French Revolution" Fleet Street. p215 An offer by the publisher for the copyright for £1000 was offered although this was said in a later publication to be inspired by a desire to suppress publication and appease the English government. "This offer was promptly declined by Mr Paine, who wrote for the benefit of mankind and not for pecuniary reward" Liberty Books Freethought Press New York preface vi

to his fifteen year old 'pupil':

> It was the early Christians who, daily persecuted for their ridiculous beliefs, used to cry: "Don't burn us! Don't flay us! Nature says that man must not do unto others what he would not have others do unto him!" Fools! How could Nature, who always urges us to delight in ourselves, who never suggests any other instincts, other notions, other inspiration, assure us in the next moment that we must not, on the other hand, choose to love ourselves should it cause others pain? Ah, believe me, Eugenie, Mother Nature never speaks to us save of ourselves; there is nought so egotistic as her message, and what we most clearly divine there from is the immutable and sacred counsel: prefer thyself, love thyself, no matter at whose expense.[23]

In parliament, and in contrast to these conservative fears about the social degenerative effects of liberty, stood the more progressive pro-market elements of the Whig party. Politicians such as William Sheridan, a rhetorician equal to Burke, argued against the Pitt government and in favour of the freedom of individuals to organise and to enjoy freedom from the increased state restrictions that followed the French Revolution and which he described as 'hysterical'.

In this political climate, many working people found themselves in an unhappy and unique situation. Suffering from the demise of a feudal social support system and largely disappropriated from their homes, the working person needed to create their own system of support and their own access to accommodation. Low wages and insecure working conditions meant that individualised private solutions to these social needs was not an option, collective solutions would have to be found. The dominant views of the state, however, still grounded in semi-feudal politics (now denuded of its socially responsible elements), mitigated against collective activity. In contrast, the liberal's support of individual expression and independence did give some ideological space to expand.

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[23] Sade, DAF (1995) The Philosophy of the Boudoir p56 Ondon Creation Books

The eighteenth century witnessed the emergence of collectives of working people who organised (under the legal form of a friendly society) to provide a 'safety net' for the insecurities of working life. However, because of the political climate, these societies overtly underlined their uncontroversial nature through the strict policing of their membership. Members of such societies could be disbarred for drunkenness, swearing oaths against the King, political discussion, adultery, and even for contracting venereal disease.

Early collectives that put money into a common fund in order to purchase property, or building societies as they became known, often registered as friendly societies in order to gain some legal status in the post-revolutionary period of uncertainty.[24] They were, as the context required, small and conservative, with the limited aim of saving collectively in order to fund the purchase of land or housing for the members. Their objects were a purchasing opportunity presented by the rise of the market but one that was proscribed by the political environment. These were the elements that constructed early mutuality.

The limited aims of early building societies meant that every member joined for the same limited purpose and, expecting the same outcomes from membership, they contributed broadly to the same degree. Each member saved and each member obtained property as a result of this continued commitment. When the objective of providing property for each member was achieved the society 'terminated', hence the early societies were called, 'terminating societies'. Originally, therefore, mutuality was not constructed by legislation or governmental policy but was something that described a method of organisation that arose organically from a particular historical context.

[24] The first such society was founded in 1767

Later, in the 1840s as the object of building societies was the acquisition of property and as property itself was political in a very particular way at this time, building societies found themselves playing a role that extended the movement in a way that fundamentally transformed the nature of mutuality. This was because as well as property being political in the macro sense described in MacPherson's thesis[25] it also was political in the sense that ownership determined political rights to a limited franchise.[26] So, following the passage of the Reform Bill[27], the vote was extended to those who owned property worth £10 in the boroughs and in the counties to £10 copyholders, £10 long-leasers and £50 medium leaseholders as well as the existing forty shilling freeholders. This meant that building societies could play a direct role in the extension of the franchise through the provision of property of sufficient value to allow the owner to meet the voting qualifications.

In 1847, the first society to operate for the joint purpose of obtaining both property and the vote was established by a James Taylor and was called the Birmingham Freehold Land Society. Liberal politicians recognized a political opportunity to increase their electorate and were quick to act as trustees for these building societies, known as freehold land societies. The conflict between conservative landowners and liberal free marketers was orientating around the campaign to repeal the Corn Laws, and building or freehold land societies became one of the

[25]described in chapter 1

[26] For liberal thinkers, it is the freedom of individuals to sell their personal skills and strengths in the market for a price determined by market forces that is the starting point for the ascendence of private property. Thus, 'having this most basic right in my own person seems to entail having the most basic of liberal freedoms- contractual liberty, liberty of occupation, association and movement and so on- and it is compromised whenever these freedoms are abridged. The connection between property and the basic liberties is in these cases constitutive and not just instrumental.'. John Gray (1986) Liberalism p58

[27] 1832

arenas in which this conflict was played out. Famous anti-Corn Law leaguers such as Richard Cobden and his compatriots purchased large plots of land to create smaller plots of land of sufficient value to give the owner the vote. The huge quantity of land that had become private property by virtue of the Enclosure Acts meant that there was plenty to purchase. The desire for homes and the vote meant that the freehold land societies were extremely popular and the support of rich politicians meant that they were highly successful. The result of this success was both the transfer of many acres of land into the ownership of working people and the increase in the number of voters by many tens of thousands.

Freehold land societies ceased to be functional as a method of extending the franchise following the Reform Act of 1868. However, the effect of the freehold land movement on the building society movement as a whole had been highly transformative. For seventy years building societies had been small in size and number, never exceeding 80 in number, but, by 1850, 2000 societies had registered under the 1836 Act.[28] In addition to this they attracted large sums of money, by 1850 the entire movement was estimated to hold a total income of £2,400,000/yr.[29] This meant that terminating societies had become increasingly inappropriate as a vehicle for organising a large membership since they were designed for a small, non fluctuating group of saver/borrower members.

The popularity of building societies during the freehold land movement era served to highlight the limitations of the terminating societies since individuals who wished to join throughout the existence of a society were often unable to do so due to the high costs of joining late and

[28] Arthur Scratchley (1858) "Industrial Investment and Emigration", 2nd edition London John W. Parker West Strand p50
[29] ibid

effectively, having to 'catch up' with other member's savings.[30]

The solution to this organisational problem was presented and published by the actuary Arthur Scratchly who argued for a society that did not terminate in a fixed period, but existed indefinitely. These he called, 'permanent societies'. Under this organizational form, members would have an individual contract with the society designating them as either investors receiving interest or borrowers paying interest. Investors would be able to withdraw their investment with relative ease, while borrowers would make periodic repayments (usually monthly) over a fixed period, making their loan arrangement 'terminating' rather than the society itself. In this way the society could extend its borrowing according the amount invested in it and borrowers could join without 'making up' the payments made by founder members.

This system was highly successful and was concretised in the 1874 Building Societies Act, remaining as the method of organising societies today. But the effect this system had on mutuality was profound. Under this system, members had distinct and conflicting self interests rather than identical or mutual interests. Saving members sought high interests on their investments, so societies attracted investment by offering good rates. However, in complete contrast, the borrowing member sought low interest on repayments and was less able to influence the interest rate policies of the society as their ability to withdraw from the society was more restricted and could put their home at risk of repossession. Borrowers represented a potential risk requiring assessment in the interests of security for investors. Building society managers, therefore, were more likely to attend to the needs of investors rather than the needs of borrowers.

The separation between borrower member and investing member and the individual agreements

[30] Chapter 1 Permanent Societies

members would have with the society rather than between each other was legally expressed in Section 9 of the 1874 Building Societies Act. This section determined that registration of a society automatically created a corporate entity, distinct from its members and possessing perpetual succession.

So, by the 1870s the Building Society movement had ceased to be a small number of intimate groupings underpinned by little or no legislation and had, instead, become a popular financial institution worth millions of pounds and underpinned by detailed legislation and regulatory bodies. The nature of mutuality altered in the context of the factors outlined above and, in addition to this, the hierarchy within societies and between societies further distanced mutuality form its origins in equality.

In Chapter 2, the development of these hierarchies is outlined and the manner in which this led to an increased separation of the member from his society is assessed. In addition to this, Chapter 2 shows how the governmental construction of mutuality ironically enhanced the power of the managerial elite by lessening democracy within societies.

As Chapter 2 indicates, the development of hierarchies had much to do with the tendency for capital within the industry to become centralised. In 1890, 2,286 societies were registered with total assets of £60 million. By 1988, total assets had increased to £188 billion but the number of building societies had decreased to 131. Furthermore, a series of amalgamations had left a handful of societies, such as the Halifax and the Abbey National, with a huge proportion of the total assets.

The power of the larger societies over the entire building society movement was increasingly exercised through the Building Society Association. This organisation, originating in 1869 as an eclectic campaigning group for the reform of building society legislation, had historically displayed an elitist agenda, particularly in relation to its lending policy and in the selection of managers. As evidenced in its early publications, it sought to focus away from mortgages upon less humble abodes and desired to draw management from the ranks of men from, 'commanding social positions'.[31]

The Building Society Association operated as trade association producing publications that gave general advice and providing a forum for sharing the views of individuals involved in the industry. However, its powers increased immeasurably following the economic slump in the 1930s when the BSA began its policy of determining building society strategy with particular reference to 'advising' interest rates.[32] Furthermore, as the executive board of the BSA was made up from the top management of the wealthiest societies, advice was effectively determined by the small, and already powerful elite of the industry.

By the beginning of the twentieth century, the mutual element of 'one member one vote' was a relatively ineffective mechanism for organizing against management decisions in large societies that had thousands of individual members and was, arguably, counter-productive. This led a number of writers to argue that building societies were no longer run for the benefit of members but for the benefit of management. Indeed, this was a view taken by many in the Labour Party in the 1960s and 1970s and in subsequent governmental green papers.[33]

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[31] BSA Gazette, No. 17. Vol.9 May 1st 1870 quoted in chapter 2 note 10
[32] This is placed in inverted commas as this advice was taken as law by all members of the BSA.
[33] Paul Barnes, Chistopher Hird. Ken Weetch MP.

In addition to the above factors, the nature of mutuality was further determined by a government policy that created legislation, confirmed in the courts, which effectively distinguished building societies from the more *laissez-faire* norms of commercial business. Whilst the company was treated with greater and greater latitude, the building society was treated as a quasi- social institution rather than a purely commercial enterprise. As Chapter 2 notes, at the same time that building society legislation was being tightened in respect of the increased powers given to its overseer, the Registrar of Building Societies, the limited liability company was enjoying increased freedoms.[34] Corporate identity was recognised upon the minimum of formalities and in respect of a company that was, in essence, a one-man business.[35] In addition to this, although the judiciary often described the general duties owed by directors of companies in the same terms as those of building society directors, in many important aspects they were treated differently. For example, in respect of maintaining company assets, the judiciary adopted a very liberal attitude to that which a company should maintain before declaring dividends, a precedent that remained in force until the passage of the 1981 Companies Act. In contrast, a building society manager was expected to recompense members for a negligently declared dividend.[36] Furthermore, although the objects of a building society were statutorily determined in each new piece of relevant legislation, the strict interpretation of the *ultra vires* rule in respect to early registered companies was gradually loosened and nearly abandoned by the judiciary.[37] Thus it can be seen that whilst the government and the judiciary, in particular, placed commercial expediency at the heart of their policy for the company, the building society operated under much tighter controls. Whilst investors in companies were protected, for the most part, by limited liability, they risked

[34] Building Societies Act 1892
[35] Salomon v Salomon (1897) AC 55
[36] Leeds Estate Building Society v Shepherd [1936] 36 Ch.D 787
[37] Contrast Ashbury Ry v Riche (1875) LR 7HL 653 with Bell houses Ltd v City Wall Properties Ltd [1966] 1 QB 2071

the loss of their original investment. In contrast, investors in building societies could expect a greater degree of protection.

However, it was the additional constraints placed on building societies for the protection of investors that produced the ultimate lure for the shedding of mutual status. Societies were required to maintain an annual reserve in order to protect its members from the fluctuations of the market. Over the years, these accumulated into substantial sums that could be used to provide cash or 'free' shares to members upon conversion. [38]

In this context, mutuality, originating as an organic expression of member's equality and control became something that was controlled and defined by the elite; the Building Society Association, the government and the judiciary. Mutuality was not a quality that a member would recognize or consider a benefit, it appeared only as a legal term expressing a remnant of the past. By the 1980s, mutuality came under heavy criticism. For the political right it represented, 'bucking the market', while for the left it represented 'elitist control'. The failure of mutuality to appeal to the entire political spectrum or to the members of building societies led, firstly, to the legislative facility to shed mutual status and, secondly, to the desire of members to make use of that facility.

Thus, the 1980s represented a period when particular factors combined to leave mutuality devoid of any supporters outside a small number within the building society industry itself. As Chapter 3 indicates, the failure of Labour's democratic socialism to impose the spending restraints demanded by the IMF, without losing their political credibility and the trust of the electorate, was a major factor (among others) in the ascendance of a new form of conservatism in the

[38] For example the 1981 Building Societies (Authorisation) Regulations required 2.5% of assets to be held as reserves.

Conservative Party, known as Neo-liberalism. Headed by Margaret Thatcher, the Conservative Party came to dominate politics, possessing both a large majority in parliament and clear, media friendly messages. Drawing upon the dominant, contemporary criticisms of the Labour Party, the Conservative Party was able to represent itself as Labour's anti-thesis. Labour was authoritarian and intrusive while in contrast, Conservatism respected an individuals privacy and self-sufficiency. 'Thatcherism', as this Neo-liberal ideology became known, argued that the social welfare policies of the Labour Party were linked with intrusive and anti-individual state activities. Thatcherism, in contrast, would enhance individual liberty by reducing the role of the state, particularly in respect of its welfare role.

According to Thatcherite ideology, the welfare state had, through over-taxation served to disappropriate individuals from the money they earned and had created a culture of dependency among those that did not, or could not, work. Drawing upon the ideas of Adam Smith and, in particular, Hayek's post-war writing, Thatcherism associated welfarism with state intrusion, and state intrusion with the oppression of individualism and entrepreneurialism.[39] It concluded that, individual creativity and productivity could only evolve in a market economy that was free from state interference. And, in the same manner that Thatcherism proved the efficacy of its ideology through the sale of council houses into the private ownership of the tenants, so it sought to draw building societies from the shackles of state policy and into the norms of market control.

The Thatcher administration achieved these aims on a number of different levels and with very little opposition. The Labour Party had already criticised the anti-market, oligargic organisation of building societies. The Wilson Report into building societies, which was eventually published in 1980, recommended the abandonment of the BSA's 'recommended' interest rate system,

[39] Hayek, FA (1944) "The Road to Serfdom" Routledge and Kegan Paul. 1976 edition

which had been introduced in order to protect the weaker societies and hence the Building Society Industry as a whole. And, it did so according to market criteria, introducing market control over the industry by encouraging, 'greater competition among the societies'.[40]

The subsequent Green Paper overseen by the Thatcher administration under chancellor Nigel Lawson concurred with the above proposal. However, like so many other pro-market strategies that were unpopular when proposed by the Labour Party, it was passed without dispute under the Conservatives. In addition to this, the 1984 green paper proposed a scheme whereby members of a society could elect to convert into an incorporated company. This innovation in building society legislation provided the legal facility to end mutuality and thereon subject demutualised building societies to the same legal norms that the incorporated company had enjoyed, and the freedoms that mutual building societies had been denied.

This was not an innovation that Labour in opposition could feasibly dispute having been the foremost critics of the existing organisation of building societies. From the tax privileges societies enjoyed, to the uneconomically large numbers of branches they maintained, Labour Party politicians consistently questioned policy in respect of building societies, comparing them unfavourably to the more 'competitive' companies. However, despite an obvious lack of opposition from the Labour benches, the Conservative's Green Paper and the resulting Building Societies Act did not make 'demutualisation' an easy option, as it could so easily have done. Under section 97 of the Building Societies Act 1986, demutualisation could only occur following the participation in a vote to that effect by 20 percent of members entitled to vote of which 75% of investors and 50% of borrowers should be in favour. This was a huge quorum, far exceeding that required in company law and far exceeding usual participation in company AGMs for even

[40] Cmnd 7937 at p114

the most controversial issues. In addition to this, under Section 98, the Building Societies Commission could refuse to confirm a transfer of business to a company subject to the proscribed criteria for such a refusal.

The unwillingness for the legislation to make conversion a simple process thus annihilating mutuality with some rapidity may be explained as the result of the contrary norms of conservative thinking. Conservative ideology, reflected in the Building Societies Act of 1986, contained a combination of free market liberalism and Burkian social order through social engineering. Thus, part of Conservative thinking, described in Chapter 3, desired preservation of building societies for the role they played in the incorporation of working members of society into the norms of ownership which helped ensure a deference and commitment to a society that protected private ownership. The privileges enjoyed by building societies were a small price to pay for the retention of their important social function. Thus, we find that most of the 1986 Act was orientated around reforming controls on building society activities to enable them to compete with other parts of the financial sector without the necessity of changing their legal form. Much of the legislation attempted to preserve mutuality by enhancing the desirability of operating as a mutual. So, were it not for the desires of society managers and society members, sections 97-103 of the Building Societies Act 1986 would have been a dead letter.

However, these sections have been greatly utilized. As Chapter 4 indicates, the management of a number of societies were extremely pro-active in the conversion process as were a small number of members. In addition to this, in almost all cases members have voted in favour of conversion by a huge majority. As a result, sections 97-103 have transformed the building society movement, taking more than 80 per cent of assets out of the mutual sector.

The Abbey National was the first society to demutualise, a process that was instigated and secured by a motivated and self-confessed pro-conversion management. Under the chief executive, Peter Birch, the Abbey forcefully put the argument in favour of demutualisation to its membership and, some argued, forcefully suppressed alternative views. It seems that the control that an elite management held over a large organisation of members precluded those very members from being able to make their views and wishes known. In effect, in the case of the Abbey National, mutuality was defeated by an absence of practical mutuality. The vote in favour of conversion, coupled with the promise of free shares upon conversion, was overwhelming and seemed to have rendered the Commission unable and unwilling to use its powers under the Act to refuse to register the transfer, despite the existence of ample evidence to justify this refusal. In addition to this, the judiciary offered a liberal interpretation of the Act, a judgment that gave rewards to recently joined society members as well as long term or 'two year' members. This meant that the process of demutualisation offered opportunities for individuals to join societies in order to benefit from free shares upon conversion. The motion to convert would often be proposed by these new members, who became known as carpet- baggers.

Whilst the amalgamation of the Cheltenham and Gloucester Building Society with Lloyds PLC in 1995 led to a court decision which limited the payment of cash to two year members only, new members could still be offered free shares as a 'reward' for conversion.[41] The third attempt by the Building Society Commission to mediate a conversion in court was in respect to the amalgamation and demutualisation of the Leeds Building Society and the Halifax Building Society. However, by this time the Commission's points had become mere legal quibble and the courts had no problem in dismissing its complaint.

[41] Cheltenham and Gloucester Building Society v Building Societies Commission [1994] Chd 65

There followed a reasonably long period between the conversion of the Abbey National in 1989 and the subsequent conversion of the larger societies, the Halifax, the Leeds, the Alliance and Leicester, the Woolwich and Northern Rock in 1997. However, evidence suggests that during this time the industry had failed to communicate to its members the benefits of retaining mutual status. As numerous speeches made and the results of studies conveyed at the Building Societies Conference of 1997 suggested, although there were clear material benefits for members in remaining as a mutual society, members were still largely unaware of these while the nature of mutuality itself remained something of a mystery.

The process of demutualisation was further encouraged by the merger activities of pro-conversion societies who had spent the years following the passage of the 1986 Act taking over the business of smaller societies, and thus removed an even larger proportion of societies from the mutual sector when they eventually converted. This was an ironic outcome since mergers were suggested as a means to protect against corporate competition by following the 'safety in numbers' principle.[42]

In contrast, over the same period, the Building Society Association displayed a remarkable apathy to the protection of mutuality, given the determination of the pro-convertors. However, eventually galvanized by the massive conversion activity in 1997, the remaining mutual members of the Building Societies Association (or rather their representatives in the form of chief executive and chairman delegates) resolved to be more pro-active in promoting the benefits of mutuality. This thesis goes on to test this resolve in Chapter 5, which introduces a survey

[42] See tables in chapter 5

designed to assess how successful the BSA and building society initiatives were in enlightening members as to the nature and benefits of mutuality.

First undertaken in 1997 and then repeated three years later, the study concluded that whilst there was a noticeable increase in awareness of the meaning of mutuality and of the benefits this form provided for the average member, this did not translate into a commitment by those members to vote in against a pro-conversion motion, given the immediate material benefits of a successful vote to convert. The survey indicated that any future votes for conversion would be more difficult to predict, although an increased awareness of mutuality may make members more likely to assess the facts of a particular conversion and they might not necessarily assume that all conversions were beneficial.

The final chapter contends that in the New Labour era, mutuality could have been expected to regenerate. Factors in favour of this contention include the increased understanding of mutuality by members, the enhanced commitment by societies' executives and a government policy committed to financial inclusion. This chapter analyses each of these factors. It begins by reviewing New Labour's 'stakeholding' rhetoric in order to contextualise its initiatives in respect 'financial exclusion'. It then examines New Labour's consideration of the building societies' role in combating this social problem. The chapter goes on to assess the views of chief executives in the remaining mutuals, based on a series of interviews undertaken in 1999. The interviews asked chief executives to explain why they considered mutual status worth preserving and the role that it could play in addressing social problems. The chapter goes on to assess the new awareness by members of mutuality, evidenced by the unsuccessful conversion motions such as those of the Nationwide Building Society.

Finally, evidencing New Labour's lack of tangible commitment to mutuality, this chapter analyses the effect of the Financial Services and Markets Act 2000 upon building societies. It contends that the effect of this Act indicates that Government policy toward mutual building societies is materially opposed to the preservation of its distinct character and is, instead, committed to homogenizing the regulation of financial services *per se*. This chapter concludes with the view that New Labour's 'third way' is a rhetorical smoke screen that does not, and will not, translate into a positive preservation of mutuality. So, whilst government policy since the 1830s has attempted to construct and preserve mutuality, the policies of administrations since the 1980's have made mutuality dispensable.

Chapter 2

The Origins of the Building Society Movement

1. Introduction.
2. The Political Context: Cool Climate For Collectives.
3. Friendly Societies.
4. The Politics of Property.
5. The Freehold Land Movement.
6. Permanent Societies.
7. The Legality of Building Societies: (i) The Pre-legislative Position.

   (ii) Legislation.

Introduction

Any historical study of the building society movement will commence with the observation that the earliest known building society was Ketley's building society established in Birmingham around 1775 and that in the following fifty years a further sixty-nine such societies were created. It will go on to describe their early organisational status as 'terminating' societies, that is, societies with a fixed membership that ended when all members had sufficient funds to buy or build their home. Such historical analysis, while providing useful material, tends to decontextualise the role of building societies from their wider socio-legal and economic function and presents the historical development of building societies as a logical progression of their internal dynamics. However, to consider the building society movement within its historical origins is to view it in the context of political conditions that would initially appear to mediate against its progression. For instance, the late eighteenth century exhibited a strong state aversion to independent organisations of working people largely because of religious and political dissent within the working classes, a perceived Jacobin threat following the French revolution of 1789 and a generalised social fragmentation caused by the rise of the market economy. Furthermore, the legality of building societies was questionable as it was possible that the aims and methods of building societies ran contrary to the aims of the Bubble Act 1720 (repealed 1825 6 Geo.4.c.91). In addition to these factors the internal divisions within Parliament and a deeply unpopular monarchy tended to result in a more paranoid response by the state to independent organisations. Thus, the very existence of building societies poses the question as to why they were tolerated and even encouraged by the state, at a time when the notion of collective organisations certainly ran contrary to the rising ideology of liberal individualism and appeared to run contrary to the political and economic necessity to discipline the working class to the requirements of the rising market economy. The government was clearly preoccupied with the activities of collectives, as a cursory glance at the orientation of statutes passed between 1790-1830 would indicate.[1]

The purpose of this chapter is to analyse the historical factors that mediated both for and against the rise of the building society movement. It will argue that it was the synthesis of these factors that molded building societies into their present organisational and ideological form, concretised by legislation, the earliest of which was the Benefit Building Society Act 1836. The mutual building society is a unique form of business organization. As Boleat observed, 'they are not companies subject to company law nor are they banks, partnerships nor co-operatives'.

Building societies were conceived as organisations that contained two distinct and contradictory characteristics, characteristics that both developed or subsided according to historical context. Building societies emerged as bodies whose class content proscribed an organisational form that was grounded in collectivity and mutual reliance. As a collective, members could achieve aims that individually would have been substantially more difficult. The inherent interdependence of members was reflected in the idea of mutuality, that is, members contributed and gained from participation equally and maintained equal rights and responsibilities in the society. In contrast, the second primary feature of building societies was inherently individualistic. The aim of a building society was the provision of private property rights to its members, rights that are grounded in an individual's absolute legal power to exclude others. Thus, while a member remained associated with a society they maintained a relationship based on mutuality with its members. However, once that society was wound up, having succeeded in housing its members

[1] As the statutes in the bibliography indicate

(in the case of terminating societies), the relationships between members dissolved, as they had then become individual private property owners.

The contrast between building society's organisational methods based on collectivity, and their aims based in individualism, became a basis of conflict and development within the building society movement, a conflict that has left individualism the victor. However, the victory of individualism over mutuality is the result of a long and varied historical process. In this chapter, this process is firstly assessed in the context of the political orientation of the period in which building societies emerged. This particular period was marked, as previously noted, by state coercion of working people's organisations such that, in order to avoid state interference and maintain independence, collectives were obliged to avoid reference to political aspirations that might be perceived as threatening the existing social order. This is clearly evidenced in the preoccupations of friendly societies in general (early building societies were not distinguished from these groups) who engaged in the self regulation of members by penalising their provocative political and social attitudes through fines and expulsions. Throughout the development of building societies there resides a preoccupation with legality and respectability, most commonly expressed by the notion of prudence. In this context, there was a tendency for the egalitarianism inherent in mutuality to be contained purely at the level of organisation. Any potential for it to be extended into its objectives were largely curtailed by the political environment.

The chapter goes on to explore the politics of individualism, articulated by the rising politics of liberalism that is inherent in private property ownership. Ideologically, this mediated against the collectivity of mutual organisation, but, conversely, whilst it diminished mutuality, it served to expand the building society movement as a whole. Exponents of free market liberalism tended to refute the more authoritarian measures of the Pitt government in respect to working people's collectives, broadly supporting freedom of choice and more explicitly upholding the value of absolute private property rights. This in itself created natural allies for the building society movement which more explicitly manifested itself in Liberal politician's financial support of the freehold land society movement. The rapid success of the freehold land societies, discussed later in this chapter, massively increased the popularity of building societies, yet it was this success that caused the first major shift from mutuality of membership to individualism. Organisationally, this was evidenced by the usurption of the terminating society by the organisational form of the permanent society. By the time the 1874 Building Society Act was passed, trends were in place that substantially reconceptualised the original meaning of mutuality. These trends may be summarised as the separation of the member as borrower from the member as lender, the rise of a professional class of building society managers and the emergence of an independent advisory body for building societies which resulted in the increased regulation of the character of the borrower and the tendency toward oligargic practices. Mutual status remained, but in a radically modified form.

Cool Climate for Collectives.

The evolution of radical political consciousness in the working classes found both form and inspiration in the pre-revolutionary politics of anti-monarchists in France. However, although the political groupings that arose in England were dubbed 'Jacobins' (generally used as a derisory term) their politics derived little from the French experience, tending instead to be constituted around notions of constitutional reform rather than notions of revolution. However, in the wake of the French revolution of 1789, such organisations were considered by governing bodies to represent a similar political threat to existing social order in Britain, particularly by leading conservative elements of the government. The result was a plethora of repressive and censorious legislative political activity in a concerted attempt to criminalise and disband working people's collectives.

One of the first notable organised collectives in this period, notable partly because of the attention it received from the state, was the London Correspondence Society (the L.C.S.). The L.C.S. was founded in 1792 by shoemaker artisan Thomas Hardy and was later chaired by Francis Place. Organised into divisions or branches corresponding with other branches in Sheffield, Manchester, Leeds, Rochester, Bath and Tewkesbury, its modest aims were to discuss constitutional reform and to correspond with similar groups. Yet, despite the fairly innocuous nature of their activities the members of the society were treated with such unwarranted and excessive repression that even a London jury would not convict them. Vividly described by E.P Thompson in *The Making of the English Working Class*; when Thomas Hardy was arrested on a charge of high treason, the penalty for conviction of high treason was sufficiently grotesque (disembowelment followed by the said entrails being burnt in front of the perpetrators face), for the jury to give a not guilty verdict; regardless of the facts and the Privy Council's determination to get a conviction on this charge.[2] After a nine-day trial, Thomas Hardy was acquitted and other members of reform groups arrested in this purge were subsequently acquitted, including activist Horne Tooke, founder of The Society for Constitutional Information, whose concerns were the free distribution of literature on constitutional reform. [3]

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[2] An argument forwarded by E.P.Thompson in "The Making of the English Working Class" (1982) Pelican Books.
[3] Ibid p20-21.

It is clear from the literature of this period that it was the organised nature of these groups, as much as their politics which caused such anxiety in the English ruling class. A level of organisation that E.P.Thompson argued, distinguished such movements from the random activities of the plebiscite 'mob'. For example, W.Windham, leading conservative politician argued in a parliamentary debate on seditious practices,

> When it was asserted, that such clubs met only for the purpose of parliamentary reform, and conducted themselves in an orderly manner, he thought that the ground for alarm was greater; just as he should have more reason to fear an hostile army on being told that it was well disciplined.[4]

In much of their organisation the many reform groups mirrored that of early building societies. The L.S.C. for example, required a monthly subscription from its members that was collected and held by a nominated official. Furthermore, it operated under fixed procedural rules and held regular meetings, in local inns, thus encompassing 'business' with a social occasion, as did building societies. Such organisational methods perpetuated both continuity and popularity enabling the L.C.S. to reach much of London, the Medway towns and parts of the north. But whilst these methods raised consternation in the context of groups like the L.C.S. it was tolerated in the context of building societies. Undoubtedly, it could be argued there is a qualitative material difference between the potentially subversive nature of organisations designed for the dissemination of ideas on constitutional reform and those constructed for the purchase of property. However, the anxiety generated in this period by the French revolution seemed to bypass rational appraisals by the state and resulted in the treating of all collectives with suspicion. Furthermore, the abandonment of a well-balanced assessment of the threat posed by collectives seemed to be considered a political virtue by the government, preferring intuition

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[4] Hansard (1793) 33 George III *'Debate on Mr Sheridan's Motion'* p542

above factual evidence, requiring building societies to underline their moderation. This anti-rational approach by politicians is exemplified in a parliamentary debate on a motion put forward by W.Sheridan, *'for the House to resolve itself into the truth of the reports of seditious practices in this country'.*[5]

In witty and backbiting speeches that make Tony Banks' politically incorrect 'foetal faux-pas' at the 1997 Labour conference seem complimentary, Sheridan and Fox put forward the argument for a fact-based assessment of the threat posed by reform collectives. Sheridan argued that the government had conspired to create a social panic, 'alarm was spread for the express purpose of diverting the attention of the public for a while, and afterwards leading them the more easily into a war'. [6] He evidenced this with a number of examples that included an incident when all the mail coaches in London were stopped and searched because the Lord Mayor had been told that there was a debating society in the Kings Arms at Cornhill. Sheridan, lampooning what he considered to be transparent repression, he said that at this Inn,

> Principles of the most dangerous were propagated, where people went to buy treason at sixpence a head, and where it was retailed to them by the glimmering of an inch of candle, and five minutes, to be measured by a glass, were allowed to each traitor to perform his task in overturning the state [7]

Sheridan went on to outline the distinctive treatment meted out to the ordinary citizen for engaging in the same kinds of debates that were regularly held in parliament, and wondered how those engaged in the latter debates could reconcile their hypocrisy,

> when they knew that poor wretches were lying upon straw in the gloom of a

[5] ibid p523
[6] ibid p528
[7] ibid p530

> prison, for having published sentiments, which they have solemnly professed in and out of parliament. The offence was the same in all, but mark the difference of the treatment! Punishment and prison were the lot of one set, whilst the others were honoured with places and emoluments and seats in his majesty's council! [8]

He noted that magistrates had the right to withdraw licenses from publicans if the discussions in the bar were, 'in the least displeasing to the government'.[9] The burden of his argument was that given the extent to which the state could and did interfere into the life of the ordinary citizen and given the hundreds of cases involving 'real hardship sustained by innocent individuals', would it not be reasonable to set up a committee to examine actual evidence of seditious practices?[10]

Upholding Sheridan's argument, Fox went on to dispute the logic of Tory spokesman Windhams' speech saying, 'in his support of the present administration he had adopted the prudent plan of giving up both fact and argument; for he could otherwise give them no consistent support'.[11]

The administration, however, clearly saw little need for evidence, preferring intuitive feelings of, 'a discontented spirit'.[12] Exemplifying this course of enquiry, Windham argued that,

> Might not a man, from a combination of various disconnected circumstances, receive a convincing impression of a general fact, and yet not be able to state any particular proofs of such fact? Would gentlemen be convinced by nothing less than ocular or tangible evidence of every subject of enquiry?[13]

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[8] ibid p536
[9] ibid p534
[10] ibid p535
[11] ibid p546
[12] ibid p540
[13] ibid p540

Concurring, Edmund Burke, conservative philosopher and politician, added that the absence of factual evidence of seditious practices in Britain was irrelevant as were the niceties of the rights of the citizen that might allow collective action. Upholding the ideals of natural rights were luxuries that could only be enjoyed by those outside government, not by the ruling administration, ('the natural guardians') whose duties lay in the maintenance of order at any cost in troubled times.

> In such times of difficulty and danger, those who saw the danger, were meritorious in accepting offices of trust and responsibility. In such times every sacrifice to the public good must be made by every good citizen.[14]

In critiquing libertarian notions such as free speech and assembly he directed his comments specifically at Fox, 'the right hon. Gentleman himself had sacrificed no interest to the value of a cats whisker. He was only sacrificing to the vilest idol that was ever set up.'[15]

Some years before, Burke had famously expressed conservative suspicion to the Jacobin threat and the perceived political shift from structured social order to individual rights in, *Reflections on The Revolution in France (1790)*. In this piece he likened the adulation of the 'liberties' won in France to a celebration over an escaped criminal,

> Is it because liberty in the abstract is to be classed amongst the blessings of mankind, that I am seriously to felicitate a madman, who has escaped from the protecting restraint of his cell, on his restoration to the enjoyment of light and liberty? Am I to congratulate a highwayman and murderer, who has broke prison, upon the recovery of his natural rights? This would be to act over again the scene of the criminals condemned to the gallies, and their heroic deliverer, the metaphysic Knight of the Sorrowful Countenance.[16]

[14] ibid p556
[15] ibid p556
[16] Burke, E. (1790) 'Reflections on the Revolution in France' p89

Fervently disputing the validity and wisdom of the universal rights of man, 'this barbarous philosophy, which is the offspring of cold hearts and muddy understandings'[17] , he argued in favour of the traditional hierarchies that characterised past stability and retained legitimacy from history. Civil society could only be maintained with:

> Public force; with the discipline and obedience of armies; with the collection of an effective and well distributed revenue; with morality and religion; with the solidity of property; with peace and order; with civil and social manners.[18]

Anxieties such as Burke's, over the disturbing effects of the French revolution, were frequently blurred into a generalised anxiety over internal disorder. The political conflict with France was readily encompassed into a conflict with the enemy within national boundaries. This is exemplified in the parliamentary debate on the Traitorous Correspondence Bill in 1793. On March the 14th 1793, the Attorney General rose to move for leave to bring the above Bill on the grounds of the law of Treason passed under Edward the Third. He moved to extend the law of treason to include acts of correspondence if that correspondence should pertain to 'commerce and intercourse with his majesty's enemies'.[19] He stated that there should be a specific, identifiable act capable of being termed treasonable within the terms of the act, '1st, compassing or imagining the death of the King.......levy war against the King; or adhere to his majesties enemies, and fluid comfort or abet them.......counterfeiting the King's money'.[20] Furthermore, he argued that the original statute had temporarily adopted specific circumstances that were deemed treasonable as and when when expediency demanded. Thus, he concluded that in the particular circumstances of war with France the Bill was justifiable in so much as it restricted such trade

[17] ibid p94
[18] ibid p90.
[19] Debate on traitorous Correspondence Bill. A.D. 1793 p582 Hansard
[20] ibid

with France as would capitalise its war effort and would allow the scrutiny of those individuals returning to England. Opposition to the Bill centered around freedom of trade and the general liberties of individuals. On the issue of freedom of trade, Mr Erskine MP argued that, 'it was surely absurd to prohibit persons from purchasing lands in France, in the present distracted state of that country, whilst this kingdom was in a condition so highly prosperous, and afforded so many favourable opportunities for the employment of money'.[21] And, on the issue of liberty he argued, that the abandonment of *mens rae* meant that an individual could be condemned as traitorous through an ambivalent interpretation of his actions, 'with as little ceremony as if it were for pulling down a turnpike gate, or for some petty offence against the excise or customs'[22] The only effect of the bill he concluded to be, 'for the purpose of strengthening the hands of the government, and weakening the liberties of the people'.[23]

As the debate continued it became clear that the Bill was designed to circumvent the activities of working peoples' collectives, with frequent references made to 'that infernal shoemaker', (Thomas Hardy), the London Correspondence Society generally and to Thomas Payne. On the issue of those returning from France, the Hon. Frederic North argued that the strictest precautions should be taken against,

> those who are gone thither to contemplate more nearly that dreadful convulsion to the moral world, with whose effects we still tremble, from whose shock we are still in danger: that their return to this country should be dangerous, it is no slander on the people to suppose: it is no slander on the people to suspect that there be amongst us many persons liable to be seduced by their communication. [24]

A near state of war had been declared on working class activity that, in the fifty year period

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21 ibid p590
22 ibid p589
23 ibid p590
24 ibid p598

preceding the passage of the Benefit Building Society Act 1836, involved the passage of overtly political Acts. From 1794 to 1822 *Habeas Corpus* was suspended no less than eight times. Legislation to criminalise certain combination of workers was passed in 1799,[25] 1800,[26] 1801,[27] 1803[28] and 1814[29]. Legislation to prohibit discussion of issues deemed contrary to the interests of the state was passed in 1801,[30] 1817,[31] 1819,[32] and related legislation in the form of prohibitions on the swearing of unlawful oaths was passed in 1810,[33] 1812 [34] and 1823.[35] These Acts, including other similar legislation carried a penalty of deportation or execution.

The conflicting politics of conservatism, as demonstrated by Burke and Wyndham, and liberalism, as demonstrated by Fox and Sheridan, helped shape the building society movement. Broadly speaking, the politics of the former concerned with social control and the maintenance of traditional hierarchies, tended to instill a sense of caution and aversion to radicalism within building societies. Eighteenth century and early nineteenth century building societies deliberately avoided a political content of other collectives despite attracting the 'labour aristocracy' normally associated with radicalism. In the latter part of the nineteenth century it was the politics of liberalism, with its emphasis on independence and responsibility that enabled the building society movement to flourish numerically and maintain a relative independence from the state.

[25] 39 Geo.3 c.81
[26] 39&40 Geo.3 c.1061
[27] 41Geo.3 c.38
[28] 43 Geo.3 c.86
[29] 54 Geo.3 c.104 & c.180
[30] Seditious Meeting Prevention 1801(41 Geo 3 c.30)
[31] Seditious Meetings, 1817(57 Geo 3 c.19)
[32] Seditious Meetings 60 Geo.3 c.6
[33] 50 Geo.3 c.102
[34] 52 Geo.3 c.104
[35] 4 Geo.4 c.87

The influence of these apparently conflicting ideologies may be evidenced in the changing attitudes within and to friendly societies generally, (before 1836 building societies often organised as friendly societies). It is clear that during the periods where the government most feared political insurrection, friendly societies consciously avoided provocative political orientations, actively engaging in the moral and political policing of its members. The latter part of the nineteenth century, in contrast, formally gave way to the liberal individualism that balked at the interference in the workings of these kinds of organisations. It is to the case of friendly societies that we will now turn in order to understand part of the socio-legal origins of the building society movement.

Friendly Societies

Originating as far back as the late seventeenth century, the early friendly societies predated building societies. However, building societies tended to operate as friendly societies, so closely did they mirror each other, that many early building societies followed the friendly societies practice of operating through trustees who, likewise, were often founder members. Furthermore, following the Friendly Societies Act of 1793, many building societies registered themselves as friendly societies, 'this made their legal position clear and extended to them the exemption from stamp duties', granted by the Act.[36]

Created and maintained as 'self help' groups for working people and operating independently

[36] J.Cleary.(1965) p14 "The Building Society Movement"; Elek Books

from recognised state authorities, their aims were largely to circumvent the grosser failures of the market to deal with problems of social welfare, such as unemployment or injury and death in the workplace. Generally, members paid a monthly subscription into a central fund and in return were insured to a small degree against the vicissitudes of working life.

For employers, seeking the maximum output from labour in return for minimum responsibility towards the workforce, the objectives of friendly societies had something to be desired. As Alan Fox notes, while the relationship between employee and employer maintained its feudal origins in respect to the 'servants' obligation to the 'master', 'the commitment of the whole person as against the segmental attachment of the alienated',[37] the 'master' required the limitation of responsibilities to his servants that could be encapsulated in pure contract. Furthermore, in purely economic terms, the relief provided by friendly societies, 'reduced the number of paupers thrown upon the parish and in this way prevented the poor rates from becoming too heavy a burden on the taxpayer'. [38]

However, inherent in the practice of collective organisations lay the possibility of a political threat to the existing balance of power, for, noted one historian, 'what was a friendly society but a popular club likely during a time of political agitation, to become a centre of Jacobin propaganda?'.[39] And, as Gosden makes clear in his historical account of friendly societies, the early nineteenth century was marked by fears about their politically destabilising effect. Home Office papers from this period evidence this. For example, in 1813, six employers in engineering firms sent a memorial complaining about the activities of their journeymen. In it they stated that,

[37] Fox, A. (1977) Beyond Contract. Oxford
[38] Halevy, E. (1924) A History of English People in 1815. T.Fisher Unwin Ltd
[39] ibid p288

'laws are artfully and efficaciously evaded and defeated by and under the mask of Benefit Societies, institutions that have created, cherished and given effect to the most dangerous combinations among the several journeymen of our district'.[40] And, in 1801 FM Eden, an individual generally sympathetic to needs of the working community, stated that, 'association is the prevalent malady of our times. In all cases its real object should be ascertained, and its progress vigilantly watched by those who are entrusted with the governance of this country'. [41]

Membership of diverse friendly societies represented a significant proportion of the working population. At the turn of the nineteenth century the population of England stood at an estimated 10 million.[42] In 1802 there existed 9,672 societies and by 1815 the number of friendly society members was estimated to be 925,429.[43] The numerical popularity of friendly societies within the context of such political flux was enough to alarm the most objective observers. For example, in P.Colquhoun's *A Treatise on Indigence* he states that with 164,424 different meetings taking place in 9,672 Inns, individuals, 'ill-informed', 'open to seduction and heated by political frenzy, artfully worked up.............may alarm and afflict the peaceful subject'.[44]

Collective organisation on the basis of shared interests was made possible by the breakdown of feudalism and the enhanced mobility of labour. This, argue many commentators, led to a new consciousness in working people- distinct and potentially more destabilising that the random activities of 'the mob'. The rapid disintegration of 'ascribed status' as a mode of social

[40] P. H. J. H. Gosden (1961) "The Friendly Societies in England. 1815-1875" H.O.42/172 Manchester UP
[41] quoted by Gosden p158 taken from F.M. Eden, Observation on friendly societies, 1801 p.24
[42] WR Cornish (1989) "Law and Society in England 1750-1950" Sweet and Maxwell
[43] Statistics from appendix No.1 of the Fourth Report of the 1874 Royal Commission Report into Friendly and Benefit Building Societies
[44] Quoted in Gosden p158

organisation prior to the eighteenth century resulted in the evolution of groups organised around the broad principle of 'justice' and a notion of class as, 'a group far from homogenous but with realisable ambitions as a group and not a mere collection of individuals'.[45] It was this new consciousness, argue many historians, which gave rise to highly politicised collectives among which friendly societies are counted.

> In the new towns there were large numbers of working men's friendly clubs and trade societies and employees' associations and combinations, the former looking to 'unions' for strength, the latter binding themselves together to protect their interests both against the farmer and the artisan.[46]

It is true that friendly societies did have the potential to be incorporated into politically radical movements and occasionally realised that potential, famously encapsulated in the plight of the Tolpuddle Martyrs. However, it is perhaps too tempting for social historians to over emphasise the radicalism of early workers' collectives in their, albeit commendable, efforts to promote the notion of the working person as an actor rather than a victim of historical events. Some friendly societies did, no doubt, provide some relief to those engaged in trade disputes. However, what is more apparent from the objects of friendly societies is their conscious attempt to appeal to the more 'respectable' elements of the working class and of their promotion of the values of abstention, hard work and saving, coupled with collectivism. Their radicalism lay not in their involvement with political issues, such as universal suffrage, but in maintaining economic independence from both government and employers by an insistence upon meticulous organisation within societies and standards of behaviour from its members. For example, as early as 1688 the articles and regulations for governing the Town Porters' Friendly Society, instituted on the 12th of March of that year, required members to be,

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[45] Briggs, A. (1959) "The Age of Improvement 1783-1867." p65 Longman
[46] ibid

> Of sound constitution, free of maim, bruise, hereditary or constitutional disease, capable to gain an honest livelihood by their employment, of good moral character, and his wife, if he has one, in good health.[47]

The rules and regulations of the Trades Society at Annan, stated in article 1 that, 'every person who should be admitted a member of this society be of good repute, and of sober life'.[48] Similarly the rules for the United Philanthropists Society, instituted in 1833 stated that members must be, 'a man of credit and reputation, his earning not less than twenty-four shillings per week, and not afflicted with diseases of any kind whatsoever'.[49]

Drunkenness was particularly frowned upon. The Castle Eden Friendly Society fined members 1 shilling for each offence of, 'drunkenness, fighting, betting and cursing', whilst at a meeting.[50] The Trades Society controlled drinking at meetings by only authorising elected officers to order drinks for the assembly and members attempting to order their own drinks were fined sixpence.[51] Claims for benefit that were considered to be self- inflicted were almost universally negated by Societies,

> No person shall receive any benefit from the stock of this society that had any distemper prior to his entrance, or whose sickness lameness or blindness, shall be caused by his own defense, or by being in any riot or drunkenness, or the venereal disease.[52]
>
> If his distemper is found to be forged or the result of excessive drinking, fighting

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[47] Article 3 of the articles and regulations of the Town Porters Friendly Society Printed at the St. Michael press by C. M'Lachan, 1801
[48] Article 1 of the Trades Society at Annan ibid
[49] Article 3 of the rules of the Philanthopists Society
[50] Article 27 of the Castle Eden Friendly Society
[51] Article 18 of the rules of the Trades Society
[52] Article 5, The Society of Taylors, Stanhope Street, Clare market, London. 1787

or quarrelling, he shall be dispelled from the society.[53]

> No benefit will be forthcoming if sickness is caused by drunkenness, fighting, unlawful or needless exercise, or from immoral conduct of any kind.[54]

Furthermore, expulsions for engagements in illegal activity were commonplace regardless of whether such actions were connected to, or affected, the member's role in the society. For example, the Town Porters' Societies articles stated that,

> When a member shall be judicially convicted of theft, or any other crime inferring infamy and moral depravity he shall therefore be deprived of all further connection with the Society and shall forfeit all he has contributed to the funds and be expelled from the Society as an unworthy member.[55]

Similarly, article 14 of the Angel Society's rules stated that, 'if any member be convicted of felony, perjury, fraud, or notable crime that may bring disgrace on the society, he shall be excluded'.[56]

To be sure, such strict policing of members indicated a clear moral agenda, (it was the whole moral and economic person that was required by Societies), but it was a morality that was internally generated. As historian David Neave argued in his archival study of friendly societies in rural East Riding, this was a morality of a distinctive working class character, not a set of moral codes imposed by middle class concerns. Although organised to help individuals, it was an organisation based on collectivity, 'the labels of 'individualism' and 'self help' should be replaced by 'collectivism' and 'mutual aid' and there is little sign of 'social exclusiveness''.[57] In

[53] Article34, The Town porters' friendly society
[54] Article 11, The Angel Inn Friendly Society, Bedford, 1826
[55] Article 44 of the Town's Porters Society
[56] Article 14 of the Angel Society's rules
[57] David Neave (1991) Mutual Aid in The Victorian Countryside: Friendly Societies in the Rural

addition, this form of moral policing bespoke of a desire to maintain some independence from the state by proving their collective ability to self-regulate. Political radicalism by members would have invited state intrusion and was generally unwanted in these stoically independent organisations. Clearly underlining this point, the Beneficit Society of Tinwold (1793) stated in their articles that, 'none shall be admitted into this Society who are suspected of being friendly to the new fangled doctrines of Liberty and Equality and the Rights of Man as set forth by Thomas Paine and his adherents'.[58] By presenting a moral and non-provocative image it 'was earnestly hoped that benevolent institutions of this nature may not be cramped by rules'.[59]

In the context of the rise of 'laissez-faire' liberal economics, this hope was to a great extent realised in the latter part of the nineteenth century, as the government acknowledged the virtue of ensuring friendly societies' relative independence from the state. In response to arguments for the establishment of a highly regulated 'National Friendly Society managed and therefore virtually guaranteed by the Government',[60] the Commission concluded that, 'the great object of fostering a spirit of independence among the people is attained by a system which leaves them to make their own provision against sickness and their own ability to work and to bear the consequences if they make an inadequate or improper one'.[61] State interference, it argued, should be limited to the provision of information upon which societies may base financial decisions and the correlation of friendly societies' accounts, 'with care to publish that guarantee is not to be implied.......sound tables may be framed, and it is intended that the condition of every society should come under periodic review'.[62] As Gosden argued, 'the principle enemy of independence

East Riding 1830-1914 p98

[58] Quoted in Gowers Principles of Company Law p31 (1992)

[59] Preface to the rules and articles of The Castle Eden friendly society

[60] cxcii fourth Report Friendly Societies Commision

[61] ibid

[62] Fourth Report of the Friendly Societies Commision ccxviii

was thought to be state aid or interference in the field of friendly society activity'.[63] Thus, the 1875 Act, though far lengthier than in previous legislation, broadly speaking limited state interference in friendly societies to the issue of registration.

Property

The particular purpose of building societies was to advance such funds as were sufficient for its members to purchase property. This apparently innocuous purpose involved the acquisition of an element of social life that was, and is, charged with political character. In the eighteenth century, the legal conceptualisation of property encompassed the evolution of socio-economic relations in Britain as both a material reality and a potent symbol of an emerging new order. It was the arena within which much of the ideological dispute between Whig and Tory took place and it was the arena within which much of the arguments for constitutional reform were fought. The reconceptualisation of property directly affected large swathes of the population by rendering them homeless and without their traditional means of survival, but facilitated the unique historical development of the market economy enabling Britain to become the first industrialised economy in the world. With the weight of history bearing down upon the issue of property, it would not be surprising that as building societies maintained as their object the acquisition of property, that the politics of property would have a profound impact on the development of the building society movement. The emergence of early building societies encapsulated a basic conflict, for whilst the members of building societies were 'buying into' the norms of a market

[63] Gosden p163

economy through the acquisition of private housing or land, they were maintaining a more desirable position of independence and self- determination.

The creation of private property in the land was almost entirely completed by the passage of hundreds of Enclosure Acts in the latter half of the eighteenth century. Over a thousand Enclosure Acts were passed from 1761 to 1780, with nine hundred being passed from 1781-1800.[64] In the period spanning 1793-1813, one thousand, eight hundred and eighty-three such Acts were passed, putting 2,2600,000 acres of land into cultivation.[65] By this process, 'common land lying continually fallow on which everyone had the right to pasture his cow, to cut a little wood, and dry some leaf, became by virtue of the Enclosure Act, the private property of an individual owner'.[66] Or as E.P. Thompson puts it, prior to enclosure and engrossment laws, land was held subject to a 'hierarchy of co-incident use-rights', a hierarchy that correlated to an individuals' social status.[67]

Property rights in land prior to the domination of the market economy did not merely denote an individuals' wealth. More significantly, it demonstrated an individuals' political, social and legal status. Formally, there was little in the way of a universally socially stratified justice although there were many exceptions to the principles of common law. For example, Scottish miners remained as 'bound labour' until 1774, slavery remained legal until 1772, while the Master and Servant Act, which made breach of contract by an employee a criminal offence, was not repealed until 1875. More significantly, property dominated the legal system by the fact that appointment to legal office carried a property qualification. W.R. Cornish, whilst maintaining that there was a

[64] P.S. Atiyah (1979) "Rise and Fall of the Freedom of Contract" p26-27 Clarendon Press
[65] Halevy "A History of English People 1815" p201
[66] ibid
[67] E.P Thompson (1977) "Whigs and Hunters:The Origins of the Black Act" Pelican Books

long- standing tradition common law in England, indicates that social position remained the cornerstone of legal appointment. Judges in the higher courts, or Royal courts were men of 'considerable social position".[68] Indeed he argues, 'it would have been remarkable had it been otherwise. Those who acquired the highest office were expected to purchase an estate commensurate with their station; and they had to show the social accomplishment befitting their place in the order of precedence'.[69] Lower down the judicial hierarchy, justices of the peace were drawn from lesser property owners and jurors too were selected by a 'householder property qualification'.[70] Indeed, those who administered justice were those who had the most to gain from existing property arrangements. In the towns, 'mill-and mine-owners were drawn onto benches, to continue there the hostilities over discipline and conditions that infected many work-places.'[71]

In Atiyah's *Rise and Fall of the Freedom of Contract*, he notes that until the complete emergence of the market economy, it was property law that dominated the English legal system, usurped in the latter part of the eighteenth century by contract law. He argued that, 'this transition from property to a law of contract relating to property merely reflects the now familiar process by which the significance of property rights changed from their use value to their exchange value'.[72] Transformed under the market economy, property emerged as just another commodity, valued by the market. Previously, property denoted stability, continuity and heritage, providing for material needs and ensuring the continuity of relationships of deference and domination. However, Atiyah's assertion that the increased ability to alienate and exchange property (through the contract form) had depoliticised property is not in accord with other important work on the

[68] W.R. Cornish p21
[69] ibid p22
[70] ibid p20
[71] ibid
[72] Atiyah op cit p103

nature of property. Macpherson, for example, argues that property itself is not neutral, but representative of a particular set of social and political relationships. He argues that, when (and only when) property is for the most part held as private property it appears to be the case that, 'property is a thing'. This is because the right to both enjoy and dispose of property is held by one legal entity. The true essence of property is that it exists as a 'political right between persons'. And, in the case of private property, it is the political right to exclude all persons from use of the thing. Alternatively, common property represents a shared mutual right of all individuals to the thing. Property rights are, by their very nature, only meaningful when accompanied by a political and coercive organisation that is capable of enforcing recognition of these rights. Private property, therefore, is only a meaningful right because of the political phenomenon of the state; an organised, specialised system of enforcement that ensures private property owners' absolute right to exclude others. The nature of a right being entirely derived from its enforceability as a claim and the enforceability of that claim depending upon a particular set of political relations.

In pre-capitalist agricultural England, an individual's legal rights to the land gave a highly visible testimony to their social status. Thus, at the level of politics, property ownership entirely determined an individual's right to enfranchisement. Ownership of property was central to the right to vote and remained so until 1868. Macphereson argues that the association of property rights with political (voting) rights had posited itself in the English consciousness for many centuries and this association was so deeply and universally entrenched that is was part of the ideology of the ruling class and radical working class groups alike. In the protracted debates on enfranchisement in the seventeenth century, that most radical of organisations, the Levellers, consistently excluded the possibility of giving the right to vote to wage labourers, beggars and to those receiving alms. The Levellers argued that these men could not experience the independence of mind and freedom that ownership of their own means of subsistence would have given them. Freedom was associated with private property ownership, and freewill could only be expressed by the free born Englishman, free because he was not dependant on the property of another. In debate with Oliver Cromwell the Leveller, Petty, stated,

> I conceive the reason why we would exclude apprentices of servants, or those who take alms, is because they depend on the will of other men and should be afraid to displease (them). For servants and apprentices, they are included in their masters, and so for those that receive alms from door to door.[73]

Whilst the Levellers argued on the basis of pragmatism or merely an acknowledgement of material reality, political philosophers, in the emerging liberal tradition, presented private property as a universal, natural and even moral right. John Locke and those following in the Lockean tradition argued that private ownership was an intrinsic quality of a physical object, and that private property ownership was intrinsic to human nature. The 'natural state' of mankind was to be engaged in private property ownership, even if that property was limited to 'property in self'. Adam Smith emphasised the importance of legislation that underpinned the absolute nature of private property rights as essential toward facilitating the exchange of goods and services. As a corollary to this, government should be restrained in their power to intervene with individual property rights; private property rights should be maintained as an immutable principle to which all other interests, including that of the governments, should be subordinate. The political theory of private property was co-opted (notwithstanding its libertarian potential) into the politics of Whig landowners who were undoubtedly keen to uphold the immutable right to private property as against the interference of sovereign or state.

[73] Quoted by Macpherson p123 in The Political Theory of Possessive Individualism Hobbes to Locke (1962) Oxford Press

Thus, property underpinned the ideology and aspirations of diverse groups in England and the economic, social and political relations therein. For the working class, private property ownership, if only in one's labour, determined freedom, in the sense of freedom from subjugation. Thus material freedom was seen as a crucial mainstay of political freedoms. For the landed Whig classes, the maintenance of private property sustained a privileged lifestyle, ironically as a moral imperative. Politically and philosophically, Whigs associated with the ascending liberal principles. The political correlation between the aims of building societies and liberalism created powerful if not pragmatic advocates for the movement. The universal right of individuals to make choices as to how they utilised and acquired property in self and other commodities served both of these group's interests.

The correlation of these interests crystallised in a surprising and ingenious manner in the middle of the nineteenth century with the emergence of a particular strand of building societies, the freehold land societies. This movement incorporated the political aspiration of working men to achieve enfranchisement and private property in land with the political aspiration of liberal politicians. Yet, ironically, it was the very success of the movement that began to undermine mutuality.

Freehold Land Societies

In 1847, James Taylor set up the first known land society called the Birmingham Freehold Land Society, its main economic purpose being to acquire freehold land by accumulated shares or subscriptions from its members, but its political purpose being the attainment of enfranchisement for its members. As such, this organisation and the others that followed represented a hybrid of both constitutional reform groups and building societies. Initially registered as friendly societies, their legitimacy was ensured by the legal recognition of building societies (in 1836) in their purpose of advancing funds for the purchase of property and subsequent societies tended to register under the Building Societies Act.

The 'Land Society Movement' owed its origin to the political opportunities for working people that were, perhaps unwittingly, opened by the 1832 Reform Bill. The Bill extended the vote to owners of property worth £10 in the boroughs and to £10 copyholders, £10 long-leaseholders and £50 medium leaseholders as well as forty- shilling freeholders in the counties.

Strictly within legal limits and aimed precisely at Conservative strongholds in the counties, Taylor organised collectives of forty shilling freeholders. Originating in Birmingham, working people were invited to become members of the society and to form a common fund based on small weekly subscriptions with which freehold land was purchased and distributed amongst its members in small plots. As long as the plots maintained a market value of forty shillings, members obtained a county vote. At the end of the first year, subscriptions amounted to £500 per month and allotments had been made to over 200 members. The movement spread rapidly throughout the country and after only three years consisted of eighty similar societies with 30,000 members subscribing for 40,000 shares with paid up subscriptions of £170,000. As building societies, they operated under trustees who guaranteed mortgages and on occasion put up the initial funds for purchasing property. Up until the 1852 election, trustees were drawn from the ranks of liberal politicians. Particularly prominent in the freehold land movement were anti-corn law leaguers and free marketeers, Richard Cobden and John Bright and their success and occasional duplicity was not universally approved, as the Morning Herald of 1852 testified in its article, *More Faggot Votes- New Purchase by the League*

> An estate containing between 400 and 500 acres of land , situated at Horfield, two miles from Bristol, has just been bought by Cobden, Sir Joshua Walmsley and another Anti-Corn Law Leaguer; for the purpose of creating 1000 40s freeholds in West Gloustershire. The property is bought at 40L. per acre, and belonged to the Rev. Mr Richards, whose solicitor took it to a country farmer looking man, who, when he had paid the deposit, gave the names of Cobden etal as the purchasers. Mr Richards has since ascertained that the estate is positively bought for these parties, and the purpose named.[74]

The mood of the freehold land movement in contrast was focused and inspired,

> Economy is the beginning of independence. A man who is always hanging on the verge of debt, is in a state not far removed from that of slavery. He is in bondage to others, and must accept the terms they dictate to him. He is not his own master, he cannot help looking servile.[75]

However, by accumulating some property and engaging in a thrifty existence,

> his self respect is maintained and he can still walk tall without the fear of parish overseers. He is no burden to society-neither himself nor his little ones. His character is unimpaired, his virtue untainted; he looks forward with hope; he can neither be bought or sold.[76]

[74] Quoted in the Freeholder's Circular No 6 Mon 2nd August 1852
[75] 'Independence for Working Men' p75 ibid
[76] ibid

The potential of this movement was soon realised in the cities and in 1849 the *National Freehold Land Society* was started with the purpose of extending the franchise and land ownership in more industrialised. areas. It opened with 750 members subscribing for 1,500 shares and quickly became the largest of all such societies. By 1852, *The National* boasted 9,000 members. It had purchased thirty- seven estates costing over £200,000 and, of the £230,000 invested in freehold societies as a whole between 1851-52, *The National* had received £96,137.[77] By 1851 it had purchased estates in many areas in and around London, including 32 acres in Stoke Newington, 204 acres in Romford and 220 acres in Barnet. Its popularity led it to publish a monthly circular, 'for the guidance of its members', which contained financial advice and a forum for discussion on the orientation of the movement and the various problems members encountered. In the first edition of *The Freeholder's Circular*, the objects of the National were stated as to, 'facilitate the acquisition of freehold land, and the erection of houses thereon, - to enable such of its members as are eligible, to obtain the county franchise, -and to afford to all of them a secure and profitable investment for money'.[78] Freehold land societies functioned as an ordinary mutual building society in that they were established under the Benefit Building Society Act of 1836 , 'for the purpose of raising a fund, out of which every Member shall receive the amount or value of his share to erect or purchase a dwelling-house, or dwelling houses, or other real or leasehold estate'.[79] However they distinguished themselves by virtue of the fact that they dealt solely in the distribution of freehold land that had not been previously built upon. Mutuality of rights between Members was scrupulously attended to, both as a virtue and as a point of marketing. The National's circular was keen to emphasise the equal opportunity of members in the acquisition of plots stating that. 'lots are after a time offered, on the same terms, to all the members'.[80]

[77] Reported in the Freeholders Circular 1st Edition 1852 p11
[78] ibid p3
[79] Benefit Building Society Act of 1836
[80] op cit Freeholders Circular

Furthermore, it emphasised the right of the members to choose the plots that were most suited to their needs, saying, 'members are enabled in a great measure to select their lots in the situations most convenient to themselves'.[81]

However, just five years into the freehold land movement, the largest and most rapidly expanding society was anxious to separate itself from the political origins of the movement, both in terms of enfranchisement and in terms of the class of persons who became members. On the second point The Freeholders Circular stated,

> It is not an uncommon opinion that the object and capacity of this society are to deal with land and houses of the humblest pretensions, and that its machinery is not adopted for property of a superior class; but experience has proved that opinion is erroneous...........Directors have experienced no difficulty in adapting the means at their disposal to the supply of the wants of all classes of the members. Already, on some of the estates, buildings of a superior description have been erected.....several of the estates now at hand are suitable for the erection of detached villa-residences.[82]

Members, whilst holding equal status in the society could make different quantities of investment (purchase more shares) and thereby receive different rewards.

On the first point, *The National* was keen to emphasise the apolitical nature of its organisation and to distinguish itself from the political (and short lived) publication *The Freeholder*. On the launching of *The Freeholder*, the *Freeholders Circular* stated,

> We have not, either directly or indirectly, the remotest personal interest in the success of that publication; and it is perhaps unnecessary for us to state, that we shall not be in any sense, or in any degree, responsible for its

[81] ibid
[82] ibid p5

> contents..........especially shall we not be identified with either the politics or the morals of Mr Cassell's paper (editor)....we know nothing of party politics, class interests, or sectarian differences.[83]

Indeed it argued, morally, socially and politically, as a society that was committed to purely commercial concerns, it, (The National) had achieved more for the lot of the common man than the overt political motivations of societies around James Taylor's original conception. As a large society, they had long since abandoned the political project that brought freehold land societies into existence.

By the end of 1852 there were 130 societies, with 85,000 members subscribing to 120,000 shares. An estimated 310 estates had been purchased divided into 19,500 allotments with paid up subscriptions of £750,000. Politically, it represented a highly successful allegiance between Liberal politicians and building societies and in the 1852 election Liberal candidates won decisive victories in the Conservative strongholds of Middlesex and East Surrey. Perhaps, ironically, the movement was bolstered by the adoption of its own tactics by the Conservative party who set up the Conservative Land Society. The experience of this society was that within four years 1,803 shares had been taken up of which £218,158 had been paid up and it had allotted 22 estates sold into plots worth £150,000.

As a politically expedient tool, the land society movement formally ceased to be functional following the Reform Act of 1868. However, as one commentator noted, as early as 1853, 'the political idea has almost vanished from the societies; members enter without any declaration of political opinion, and not one in 500 cares a rush about the franchise at all'.[84] Land societies had

[83] ibid p12
[84] Editorial from Chambers' Edinburgh Journal, 10th Dec, 1853

become successful economic organisations that were easily subsumed into the building society movement. So, for instance, marrying the status of both building society and land society, the Birkbeck Freehold Land Society and the Birkbeck Building Society, although legally separate organisations, operated from the same building and under the same management.

The freehold land society movement graphically joined politics and property under the organisational tool of the building society, yet, significantly, the success of freehold land societies served to undermine the original conception of mutuality. Compared to the early building societies with memberships of around fifty, freehold land societies were huge. Some, like The National, numbering tens of thousands in their membership. The numbers involved meant that many freehold land societies offered extra shares to those with the means and desire to finance them. Different levels of investment by members meant the acquisition of more property, thus making them attractive propositions for the more moneyed classes.[85]

However, the most important factor in reconceptualising mutuality lay in the reorganisation of the mutual society. The political objectives of freehold land societies meant that they had no reason to terminate and membership was not limited to the founding members. This lay the foundations for the emergence the successor of the mutual terminating society, the contemporary, permanent building society, an organisational form that separated the role of borrowing member from investing member whose relationship was mediated through an outside entity, the incorporated building society.

It is interesting quirk of history that whilst the liberal, free market agenda was pursued in the

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85 Evidence by Table: "Subscriptions of Members form Commencement of Society to Present Time" (Freeholders Circular) op cite

mid-1800s by bolstering the building society movement, less than a century and a half later, the Neo-Liberal agenda would be served by eradicating mutuality.

Permanent Building Societies

Early building societies, as previously noted, tended to be orientated around a small, local membership, meeting and often forming in local hostelries. Thus, members tended to have a direct acquaintance with each other. As building societies developed into larger concerns, (a tendency accelerated by the emergence of land societies) members would more frequently have no personal knowledge of each other. Whilst it is a truism that the larger the organisation the less likely it will be that members have a familiar relationship, it is commonly assumed that it was this that accounted for the demise of mutuality itself. As a Royal Commission noted, 'when, to use the words of the secretary of a large London society, men can 'come out of the street' and borrow from the society - it can no longer be said that the element of mutuality is essential to the type'.[86] This assumption entirely depends on the association of social responsibility with intimate knowledge of the other. In contrast, this thesis maintains that the shift in member's allegiance to mutuality derives from the organisational form taken by building societies that began to dominate from the middle of the nineteenth century, a form that largely reoriented member's relationships, from a collective relationship with each other within a building society, to an individualised relationship with the building society (reconceptualised as a separate body). The organisational form that facilitated this shift was the permanent society, which emerged as a

[86] Fourth Report of the Commissioners appointed to inquire into Friendly and Benefit Building Societies 1974 p13

response to economic imperatives but whose effect was to diminish mutuality.

The first promotion of the permanent society is generally attributed to actuary Arthur Scratchley. Scratchley highlighted two attributes of terminating building societies that made it imperative to adopt the permanent principle of organisation. The first of these attributes was the general popularity of building societies, the second being the inadequacies of member's actuary skills. On the first point, he argued, 'no benefit building society has ever been started however ridiculous its pretensions, which has not speedily succeeded in drawing together a number of shareholders'.[87] He estimated that by 1850, the 2000 societies that were registered under the 1836 Act would hold a total income of £2,400,000/year. On the second point, he noted a general inability to calculate compound interest that led many building societies to misrepresent the financial benefits of membership. In his words, 'not one in twenty, or even a greater number can possibly realise for its members, whether investors or borrowers, the advantageous results originally promised'.[88] This problem, exacerbated by an uncritical enthusiasm for building societies, could be resolved by the use of a permanent system. Scratchley argued that the benefits of a permanent over a terminating society were, in the main that, 'the difficulty of funding borrowers, at any time in the course of the existence of a society is removed........ members don't pay arrears if they join later and the numbers of share holders increase rather than diminish in the life of a building society'.[89] In contrast, a terminating society was founded upon a fixed number of subscribers who paid a monthly subscription until all members had received housing and had paid off outstanding loans undertaken for that purpose, housing, in the main, being allocated by a lottery scheme. Members who wished to join after the founder members were required to pay

[87] A. Scratchley (1848) "Industrial Investment and Emigration" 2nd edition London John W. Parker West Strand p7
[88] ibid p50
[89] ibid p52

higher premiums in order to equalise with the payments of earlier subscribers, that is, individual subscriptions were determined in line with the finite life of a terminating society. This meant that if a member joined half way through the life of the terminating society he would be required to pay double the premium as that paid by founding members, a sum that would obviously increase the later a member joined. This inhibited the desirability of late entry and, as a result, terminating societies would tend to have only a small number of members. In contrast, in a permanent society, the large number of members would mean that the administrative costs of setting up and running the society could be more equitably spread. Furthermore, members could withdraw their investment more readily and the duration of investment could be more easily ascertained.

These stated advantages notwithstanding, it appears to be the case that the development of permanent societies was not the result of conscious planning. In the 1874 Royal Commission Report it was noted that it was probable that permanent societies grew organically from the tendency of larger terminating societies to incorporate members throughout their existence, creating indefinitely existing terminating societies. Thus the terminating aspect of these societies more correctly described the relationship of individual members to the society, rather than the organization per se. Put another way, 'a permanent society is a terminating society to every individual from the date at which he enters'.[90]

Terminating societies operating with an increasingly unwieldy membership were experiencing organisational problems that the permanent system could easily accommodate. For example, terminating societies tended to engage in periods of great economic activity followed by more fallow periods. As the commission noted,

[90] op cite Royal Commission p14

> it is a pretty general feature amongst terminating societies that all their activity is concentrated within the first few years of their existence. During these first few years, again, it is almost invariably the case that they resort very largely to loans, in order to obtain as much money as they can for the placing out; advances being made either on the principle of ballot, or of sale to the highest bidder..........during the latter years of their existence, as repayments come in more and more, terminating societies have generally a plethora of money.[91]

In contrast, permanent societies operated on the more regular basis of supply and demand. Investments determined the capital available for the making of loans, capital obtained either through deposits or through paid up shares. Thus the Commission concluded, 'that there be no alternation of energy and stagnation: the money has not all to be put out in the first few years: the demand for it increases steadily with the progress of the society'.[92]

Crucially, as Scratchley had noted some years before, this was facilitated by the separation of members into two separate classes, borrowers and lenders, each class maintaining entirely distinct roles and benefits. A borrower would receive a full advance, secured on a mortgage, itself secured by fixed monthly repayments. Thus 'the members, who become borrowers, at once cease to be investors in respect of the shares on which they obtain advances', this means that they 'do not participate in any of the subsequent liabilities, or expenses of the society, nor consequently in its profits'.[93] In contrast, investor members do participate in the profits made by the society, and this is the sole motivation to becoming members (although in practice individuals may be both borrowers and investors).

The absolute mutual character of terminating societies that derived from member's equal

91 ibid p13-14
92 ibid
93 op cit Scratchley p64

engagement, commitment and benefit in the organisation was necessarily undermined by the organisation of the permanent principle. In a terminating society members invested in order to borrow, this collective participation enabled them to do as a group what they could not do as individuals-achieve the relative independence of home ownership. This collective solution was embraced precisely because of the economic status of members who, as noted earlier, were largely composed of the better-off working class. In contrast, permanent societies distilled the two functions performed by members into two distinct roles, investor and borrower, thereby drawing a distinction between the benefits and responsibilities attributed to each. In the words of the Royal Commission, 'instead of all the members being expectant borrowers, as appears to have been first the case, and is still the case in some groups, the two classes of investors and borrowers are now distinct, the former usually outnumbering the latter and monopolising the profits'.[94]

Investing members were drawn into the society by the prospect of expanding their own private capital by lending money, secured by a mortgage on property, to individuals who could only finance such purchases by monthly payments over a number of years and who paid a premium on these advances. Investing members, therefore, were induced to invest by two main factors. Firstly, the degree to which borrowing members would pay additional moneys on their advancement and, secondly, upon the security of the investment, in short, the character of the borrower and that of the property held by mortgage.

Mutuality remained, to the extent that all members were economically interdependent but was undermined to the extent that the self- interest of investing members and borrowing members conflicted, as the role of former had become usurious in character. To be sure, some societies

[94] op cit Royal Commission p 13

chose to limit this tendency. For example, the Leeds Permanent Society followed a strategy of minimising the difference between the interest paid to its investors and the interest charged to its borrowers thereby circumventing the permanent's tendency to divide mutuality between members. Thus, as the Commission reported, 'the borrowing member stands absolutely on the same footing as the investing member, as respects the sharing of profits, the right of voting, &c'.[95]

However, it was more frequently the case that the separation of the two classes of members led to the charging of high interest rates to borrowers; 'the mere fact that the usual recommendation which building societies put forth for themselves is the large rate of profit they give to investors, is clear proof of the high rate which the borrower has to pay for his money.[96] Furthermore, the emerging oligargic tendencies of building societies meant that the borrower had little choice but to accept the high rates charged. In evidence to the commission, James Taylor stated that, 'people would not come to our society if they could get their money elsewhere. If a man could get the money in any other way besides belonging to our society, he would never pay a £50 premium for £500'.[97]

As a result of the usurious character of the investor member under the permanent's method of organisation, the social class of participating members shifted from the 'industrious classes' to the middle classes, the latter being particularly represented in the investing class. Furthermore, witnesses to the Commission testified to the corrupt character of the growing domination of middle class membership in permanent societies, evidence which, on the face of it, the

[95] ibid p15
[96] ibid
[97] ibid Q. 3802. P15

Commission clearly disapproved,

> It is, indeed startling to hear of single advances, not only of thousands but of twenty of thirty thousands pounds being made by building societies, sometimes on the security of mills and factories; and it is roundly alleged by some witnesses that the working classes, by whom and for whose benefit the system was primarily devised, are discounted and kept away.[98]

However, the use of building society funds for these purposes seemed more the exception than the rule. Evidence from the Building Society Protection Society (BSPS) indicated that advances tended to be small and non-commercial. Their statistics drawn from 251 societies indicated that 69,879 advances were made on the 'lower rate', (set at £300), while only 9,393 were made on the higher rate (advances over £300). The proportion of lower rate advances to higher rates, about nine to one, was however lower in London at about six to one. The BSPS nevertheless concluded that building societies still maintained their roots within the 'industrious classes'.

It was, however, less difficult to ignore the class divisions between the terminating system and the permanent system. The commission observed that, 'whilst the smaller terminating societies remain very often still under the management of the working classes, or of persons very near to them in point of station, the larger permanent societies at least are almost invariably under the direction of the middle class'.[99] Furthermore, this division tended to be reflected in the class composition of the membership, particularly in the metropolis where, 'working men seem generally to form only a minority in the permanent societies as compared with the middle classes'.[100]

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[98] ibid p16
[99] op cit Second Report p16
[100] ibid p17

Thus, the growth of the permanent system, emerging as a practical response to the general popularity of building societies brought with it certain characteristics that undermined the principle of mutuality. It separated the role of borrowing from investing member, which inevitably separated their interests. Investing members required high returns from a secure investment, thus, borrowing members would inevitably pay higher interests rates on moneys advanced and would be subject to assessment of their personal suitability as borrowers. This, more complex process, exacerbated by the growing size of building societies, necessitated the growth of professional arbiters of member's conflicting interests. Assessments as to the security of an investment, that is the character and financial status of a proposed borrower, operated under the ambit and determination of a wealthy, managerial strata utilising an increasingly homogenised and discriminatory criteria. As it tended to be the middle class that were investor members and the working class that were borrower members, by favouring the interests of investor, societies were favouring the interests of the middles class. This class division was exacerbated by the fact that the required qualified actuaries and managers were drawn from the middle class, particularly in respect of the largest of building societies, which were permanent societies. So, as the permanent system quickly replaced the terminating system it increasingly sidelined the interests of less wealthy members.

The Legality of Building Societies

The Pre-legislative Position

Building societies operated for over sixty years without any legislation specifically designed for their usage, their internal organisation proscribed by the members rather than by legislation. Despite this, most building societies organised themselves in a fairly similar manner. Although there were many differences in the cost of subscriptions, methods of allocating property and penalties for defaulting members, societies operated under a system whereby members received equal benefits for equal contributions and once all members had been allocated housing, the society was terminated. However, the absence of legislation placed a question mark over their legality. Some building societies, as previously noted, registered themselves as friendly societies under the 1793 Act. It is uncertain if this did anything to improve their legitimacy as this legislation was designed for societies to raise funds to relieve poverty caused by unemployment, death or illness. Furthermore, the ambivalent legality of building societies was further exacerbated by the Bubble Act of 1720.

The speculative nature of shares that boomed in the early part of the eighteenth century caused a national economic crash when the financial 'bubble' created by massive share speculation in the South Sea Company (purportedly operating profitably in the South Seas), finally burst. In response to this economic catastrophe the Bubble Act that was passed in 1720, to protect the South Sea Company, was retained for nearly 105 years[101]. The Bubble Act prohibited the raising capital from freely transferable stock, without permission from Crown or Parliament in the form

[101] The directors of the South Sea Company were concerned that the general popularity of shares would undermine their market position, so a government that was entirely bound up with the company's fraudulent activities, were happy to pass this protectionist legislation.

of a Charter or an Act of Parliament.

Problematically, building societies operated by allocating shares to its members through subscriptions, (shares that could be transferred in many cases) and they did so without obtaining a Charter or an Act of Parliament. Predictably, this question was raised in court and in 1812 the question of whether the Bubble Act applied to the activities of Building Societies was answered.[102] In this case, the defendant sought to establish the illegitimacy of building societies in order to avoid his financial obligation as guarantor to a defaulting member of the Greenwich Union Building Society. The defense was mounted on two counts, firstly on the basis of the Bubble Act and secondly on the basis of restraint of trade as the building society employed particular tradesmen in the construction of member's homes. On the first issue the defense argued that,

> The clubbing together of numbers of persons with transferable shares, even though limited, for the purpose of carrying on trade was one of tge very mischiefs intebded to be prevented by the Act: it is calculated to put down individual industry and competition which is most advantageous for the public.[103]

In response, the plaintiff argued that although the defendant was correct in stating that article 30 of the society's constitution stated that, 'every member should have full power at all times to sell his shares privately and at what price he should think proper', this was subject to the proviso that, 'no person should be permitted to purchase any share until he should have been approved at a meeting of the said society by at least three-fourths of the members present'.[104] As such, so-called 'freely transferable shares' were subject to the approval of the majority and the court

[102] Pratt v Hutchinson (1812) 15 East KB 511.
[103] ibid p938
[104] ibid

found in favour for the plaintiff. In respect to the particular issue of restraint of trade the court stated that, as the employment of certain tradesmen was subject to the approval of the membership, it could not constitute a subversion of market criteria. And, in respect to the broader issue of the legality of building societies per se, they established that the Bubble Act could only apply to those organisations that utilised the freely transferable share. The rules of the society provided for this restriction by stating that each member could sell his shares if,

> the purchase should be approved at a meeting of the society, and should on his admission, become a party to the original articles for there is nothing illegal per se in the general object or in the mode of executing it: nor is such limited power of transferable stock within the mischief of the Act.[105]

The decision in this case rested upon the mutuality of building societies that was, at this time, derived largely from their localised nature and upon member control over transferability of shares. In this, the decision drew from the precedent set by the judicial attitude to the Bubble Act and Deed of Settlement companies.

Deed of Settlement companies operated under trustees, raising funds from individuals legally constructed as beneficiaries to the trust, and had became a popular method of circumventing the effects of the Bubble Act. A.B. Dubois argued that the Deed of Settlement Company became a legal device commonly utilised from the onset of statutory restrictions.[106] Members of these unincorporated companies agreed to be bound by the terms of the deed that provided for the transferability of shares, subject to limited restrictions. The relationship between participants in Deed of Settlement Companies was said to exist in contract, thus, the doctrine of privity of

[105] ibid p939
[106] A.B. Dubois (1938) The English Business Company After the Bubble Act 1720-1800, Columbia University.

contract further underpinned the non- transferable character of these investments. Likewise, building societies could base on argument in privity and, in addition to this, the internal restriction on transferability of investments meant that (in terms of the Bubble Act at least) they were not illegal organisations. Building societies had accidentally benefited from the successful attempts of larger businesses to continue trading in shares and, in so doing, their legitimacy in general was acknowledged, latterly subject to the avoidance of 'illegal' activities under the Friendly Societies Act of 1834. However, it was not until some years later that Building Societies had legislation that specifically legitimated their activities.

Legislation.

In 1836 the Benefit Building Society Act was passed. However, although this Bill was passed to, 'afford Encouragement and Protection to such Societies and the Property obtained therewith',[107] and whilst this bill acknowledged the existence of building societies amongst, 'the industrious classes', parliamentary records prior to 1836 indicate that there was little concern or knowledge of building societies within contemporary governing bodies. The Bill was passed with no recorded debate and, perhaps for this reason, became subsequently renowned for the ambiguity of its drafting.

Contained in nine short sections it made the following provisions. It made lawful the establishment of building societies and enabled them to take action against defaulting and fraudulent members by, 'such reasonable Fines, Penalties, and Forfeitures upon the several

[107] The Benefit Building Societies Act 1936, the preamble

Members of any such society who shall offend any such rules'[108] and exempted societies from the payment of stamp duty upon the transfer of shares.[109] In return for this legal protection societies were made subject to the laws pertaining to usury[110] and were prohibited from investing in, 'any savings bank, or with the commissioners for the reduction of national debt'.[111] Building societies could now register as a specific form of friendly society with the Registrar for Friendly Societies.

However, the modest but comprehensible provisions contained in most of the Act became confused by the provisions contained in section 4, when the expansion of the building society movement, stimulated by the freehold land movement, rapidly outgrew the intentions of the Act. Section 4 aimed to extend the provisions of the Friendly Society Acts of 10 G.4. c.56. and 4&5 W.4.c.40 of the Benefit Building Society Act. Quoted in full it stated,

> And it be further enacted, That all the Provisions of a certain Act made and passed in the Tenth Year of the Reign of His late majesty King George the Fourth, entitled An Act to consolidate and amend the Laws relating to Friendly Societies, and also the Provisions of a certain other Act made and Passed in the Fourth and Fifth Years of the Reign of His present Majesty King William the Fourth entitled An Act to amend an Act of the Tenth Year of His late Majesty King George the Fourth, to consolidate and amend the Laws relating to Friendly Societies, so far as the same, or any Part thereof, may be applicable to the purpose of any Benefit Building Society, and to the framing, certifying, enrolling, and altering the Rules Thereof, shall extend and apply to such Benefit Building Society, and the Rules thereof, in such and the same Manner as if the Provisions of the said Acts had been herein expressly re-enacted.

[108] ibid section 1
[109] ibid section 8
[110] ibid section 2
[111] ibid section 6

The vague and illogical nature of the phrase, 'so far as the same, or any part thereof' left subsequent registrars unsure as to which parts of the two existing Friendly Societies Acts were to apply to building societies; the exemption from stamp duty was already expressly provided for in the 1836 Act. Attempts at resolution of these ambiguities in court only partly clarified the issue and registrars continued to adopt different definitions of its meaning. In the words of the Royal Commission report on Benefit Building Societies, 'the act so bristles throughout with doubts that, to use the words of a witness, 'almost every line of it' has had to be brought to the test of judicial interpretation'.[112] These problems were further compounded by the passage of further Acts pertaining to friendly societies leaving the registrars ensure as to which Acts were to apply to building societies. Commissioners reported that,

> The three registrars have adopted each a different construction of the law, and have grounded a different practice upon it, so that if the registrar for England be right the registrar for Scotland must be wrong, and visa versa: the registrar for Scotland having indeed the merit of enforcing safety by combining the requirements which correspond to each conflicting construction. Hence it is doubted whether at the present day there is any valid registration since 1850.[113]

Furthermore,

> The peculiarity both of the laws relating to benefit building societies and to loan societies is that they embody and keep alive, with respect to those bodies, certain provisions of old Acts relating to Friendly Societies which are extinct as to Friendly Societies themselves.[114]

Building societies, subject to the divergent interpretation of the registrars, operated under

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[112] s.20 p9 Second Report of the Friendly Societies Commission on Friendly Societies, Pt 1 Report of the Commissioners on Benefit Building Societies

[113] ibid s.19

[114] op cit fourth report p54

legislation that maintained many of the privileges and restrictions that friendly societies had ceased to enjoy. Operating under 10 geo.4.c.56.s5 building societies maintained a right of appeal to the justices in the event of the registrar's refusal to certify all or some of the rules submitted to him but friendly societies had lost this right under 18&19 Vict. C.63. The formalities required in order to alter or repeal rules in building societies applied generally to all, but for friendly societies the procedure was set in the individual rules of a society under s.25 of the 18&19 Vict.c63 s.3. Similarly, the procedure for appointment of members to the committee in a friendly society was set in their particular rules, whereas in building societies, procedure was generally proscribed by section.12 of 10.Geo 4, c.56. Distribution of estates of building society members dying intestate could be distributed to the next of kin if the sum did not exceed £20. The sum in friendly societies was set at £50.[115] The Commission concluded that building societies in their present form were, 'nothing but a friendly society of a pattern now obsolete'.[116] In particular, they were concerned with the lack of regulation in the form of 'yearly returns to a public office'. Once registered, a building society was relatively independent, although registration itself was often subject to dispute.

The Building Societies Act of 1874 sought to redress some of these disparities and to acknowledge the specific developments in the building society movement itself. Section 5 distinguished and defined a terminating society from a permanent and section 9 underlined the growing separation of the organisation from the members by determining that incorporation was the direct result of registration, so that,

> Every society now subsisting or hereafter established shall, upon receiving a certificate of incorporation under this Act, become a body corporate by its registered name, having perpetual success, until terminated or dissolved in

[115] 18&19 Vict c.63
[116] op cit Fourth Report p10

manner herein provided, and a common seal.[117]

Individualised members now had an individual relationship with a distinct entity, the building society. For the borrowing member this was determined over an agreed fixed period which would be considerably longer than that prescribed for investing members. Investing members retained a relationship with the society if it continued to serve their economic interests to do so. Crucially, the new societies were not made up of members and indistinguishable from the membership, they were distinct entities that mediated the financial interests between borrowing and investing members.

With the exception of those societies already in existence[118], members of societies that failed to register would be personally liable for, 'every day business is carried on'.[119] Under the same section, officers of registered societies that exceeded amounts in loans and deposits proscribed by the Act would be personally liable for the amount loaned in excess of this sum. Furthermore, the falsification of accounts could result in a summary conviction upon complaint by the registrar.

But, provided that societies were established for purposes proscribed by section 13 and the rules of the society were set out in the terms proscribed by section 16 (pertaining to the way in which funds were raised, withdrawn, the alteration of rules, auditing, members meetings, powers of directors, penalties for members and the procedure for termination of the society), the registrar was obliged to register them. This set aside the discretion that previous registrars had exercised.

[117] Building Societies Act 1874 section 9
[118] ibid section.8
[119] ibid section 46

The regulation of a building society's finances was provided for in the following sections. Under section 15, societies could borrow money not exceeding two thirds of the amount secured by mortgages. And, officers in charge of money were required to give security to the society, 'in such sums as the society require, conditioned for rendering a just and true account of all moneys received and paid by him on account of the society'.[120] Under section 31, persons receiving funds by false representation would be liable on summary conviction to a fine of up to £20. Amalgamations of societies were permitted under section 33, if three quarters of the members holding two thirds of the shares, voted in favour, the same number being required for the dissolution of a society.[121] Under section 34, disputes were to resolved by arbitration and the decision of the arbitrator was to be final.[122] Societies were required to compile accurate annual accounts for its members under section 40 while under section 44, the state held the right to check these accounts, 'make regulations respecting the fees, if any, to be paid for the transmission, registration, and inspection of documents under this Act, and generally for carrying this Act into effect'.

The broad aim of the Act appears to have been the provision of a framework for the regulation of building societies as distinct financial institutions and to facilitate the monitoring of their activities whilst allowing them certain freedoms in their internal organisation. However, legislation was quite clearly intended to maintain building societies as socially useful organisations that facilitated the respectable activities of working people. Thus, unlike the commercial company, whose activities had been extensively liberated in legislation such as the Limited Liability Act 1855 and the Companies Act 1862, the activities of building societies were

[120] ibid section 23
[121] ibid section 32
[122] ibid section 36

heavily prescribed.

However, as this thesis contends in the following chapter, the early legislation did little to control the activities of the directors since legislation did not counter the numerical power that larger societies could enjoy. With the growth in size of societies, and the emergence of a managerial strata, much of the freedoms incorporated in the Act were left in the hands of professional managers. This led to a number of notable financial scandals following the passage of the 1874 Act and was, in part, responsible for the emergence of more proscriptive legislation which increased the powers of the registrar and required high degrees of security for moneys advanced to borrowing members. It also led to enhanced self- regulation, in the form of an empowered trade association for building societies which, in turn, was partly responsible for the centralisation of power and the emasculation of mutuality. The following century would see the nature of mutuality further reconstituted under the influence of number of conflicting and complimentary factors. These factors enhanced external controls over building society activities in the form of legislation and case law, aspects of increased internal control over building society activities resulting from the centralisation of building society funds and the centralisation of policy decision emanating from the Building Society Association.

Chapter 2

From Expansion to Centralisation: The Political Construction of Building Societies

1. Introduction
2. The Building Society Association
3. Elitism and the Building Society Protection Society
4. Building Societies: The Avoidance of Commercialism
5. Depression and Laissez-faire: The Registered Company v The Building Society
6. Conclusion

Table A: The Growth of Building Societies from 1895-1988.

	Number of Societies	Total assets in £ Millions	No.of Savers in 1,000s	Borrowers in 1,000s
1895 *	2442	45	625	not available(na)
1890	2,286	60	600	na
1920	1,271	87	700	na
1950	819	1,256	1,500	1,500
1970	481	10,819	10,900	3.700
1988	131	188,844	48,100	7,400

Sources: Successive Annual Reports of Chief Registrar of Friendly Societies of BSC.

*** 1895 statistic from M.Boleat.**

Introduction

Following the passage of the 1874 Building Society Act, the building society movement continued to expand, for the most part, under the legal form of a permanent society. Notable in this expansion, as Table A above indicates, was the attendant centralisation of finance and power within the movement, as the number of building societies decreased whilst the money invested and borrowed increased. This centralisation resulted from two main factors. Firstly, finance became centralised as building societies tended to amalgamate, smaller societies becoming less usual and terminating societies reaching their designated aims. Secondly, control became more centralised as the building society movement developed and adopted a single central advisory organisation, now known as the Building Society Association, which increasingly came to dictate policy for almost all societies.

These developments had a fundamental effect on the nature of mutuality. Firstly, the individual power of a member was diminished as building societies increased in size, and the value of an individual vote became diluted. Furthermore, the centralised control exercised by the BSA meant that major decisions regarding local societies were taken at a national level by an increasingly small, but powerful group. This meant that although the 'one member one vote' aspect of mutuality remained, in the context of the developments outlined above it could no longer function as a method of empowering members. One vote, in the context of a society of thousands, had little effect, allowing control by the BSA to prevail unchallenged.

The second major development in this period emerged from a governmental and judicial policy of constructing building societies as a social institution that existed for the worthy purpose of integrating the 'industrious classes' into the norms of a commodity-dominated society. To this end, legislation was increasingly concerned to control the extent of the activities in which a building society could engage and to ensure extensive monitoring. Complimenting this perspective, the courts consistently treated building societies to stricter interpretations of the law than that applied to their commercial counterpart, the limited company. In this way, statute and common law operated to artificially construct the notion of mutuality as implying membership of a prudent and highly regulated and therefore safe financial institution

The purpose of this chapter is to more fully examine the centralisation of power following the 1874 Building Societies Act with reference to the Building Society Association. It will then assess the proposition that building societies have been subject to politically determined governmental intervention and in contrast to the company, they were not considered to be merely a commercial institution, but rather, lying somewhere between the commercial and the social. This will be illustrated by comparing the law pertaining to building societies in respect of its powers and the duties of its directors, with that pertaining to companies. Finally, this chapter will assess the manner in which these factors lay much of the foundation for the demutualisation of building societies.

The Building Society Association

The Building Society Association was, in a previous incarnation known as the Building Societies Protection Association, the latter formed in 1869 whilst the former reformed with enhanced powers in 1936. The Building Society Association was established as a trade association for building societies, informing and advising its members on such issues as economic and legislative changes.

Historically, the emergence of one single organisation representing the estimated 4,000 building societies (of hugely varying sizes) in 1869, seems to have derived from a series of events that threatened the privileges that building societies enjoyed over other financial organisations. The collective response of a number of groups to these threats, (activists largely derived from the larger freehold land societies), led to their gradual consolidation into one organisation that began its life agitating for the radical reforms that led to the 1874 Act, previously noted.

The single issue that consistently exercised the societies was that of stamp duty, a problem that arose from the notoriously vague wording s.4 of the 1936 Act, which stated that the provisions of the Friendly Acts were to be utilised by Benefit Building Societies when applicable.[1] An earlier Friendly Societies Act stated that friendly societies were exempted from stamp duty on all of its business documents.[2] The unresolved question for building societies was therefore whether or not they were likewise exempt. The ongoing campaigning for this privilege led to the formation of a number of groups.

In his account of the campaign for stamp duty exemption, Cleary notes that a committee representing six Bowkett societies was formed but ceased activity after a year as it could not, at this point in the movement's history, gain the support of societies outside of London. More successful was the Building Society Institute that formed in 1848 and could communicate to building society members through *The National.* The Institute championed a bill to amend the 1836 Act, an issue which galvanised much support from diverse societies and persons, including

[1] Noted in chapter 1
[2] 1829 Friendly Societies Act clause 37

the influential registrar Tidd Pratt. When, finally, the issue of applicability was resolved in the courts[3] the Institute continued to meet and 'continued to act as arbiter and advisor on matters of professional practice' .[4] So when, in 1855, the government made one its most serious offensives against the building societies' exemption from stamp duty, building societies responded immediately, as an organisation. The particulars of this offensive were as follows. The government introduced an amendment to a Bill pertaining to Friendly Societies to the effect that building societies would have had their exemption from stamp duty removed.[5] The government and the treasury expressed the view that building societies no longer represented the interests of the poor and could therefore no longer be viewed under the same terms as friendly societies. Building societies, it was argued, were merely vehicles for the rich and stamp duty exemption was nothing short of defrauding the treasury.

In the Birmingham area, James Taylor's building societies began organising following information from their MP, Mr Scholefield.[6] Likewise, in Liverpool a number of societies formed the Building Society Protection Association while in London many societies organised under James Higham. Whether as a result of the activities of these organizations, or because of the intrinsic paternalism of the House of Lords, the latter struck out clause 13. However, the societies had seen and would continue to see the importance of political representation and the ease with which a central organisation could achieve this.[7]

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3 Walker v Giles (1849) 18 L.J.N.S.,CP.330

4 Cleary, J (1965) "The Building Society Movement" Elek Books p83

5 Amendment to 1855 Friendly Societies Act clause13

6 Mr Scholefield had been chairman of the Freeholdland society and had tried to have the offending amendment clause in the Friendly Societies Bill removed, but was defeated.(Hansard 1855

7 The government made several attempts to remove stamp duty exemption, namely the Money Bill in 1855, One of 36 resolutions from Gladstone, and Clause 10 of the Inland Revenue Bill

So, in 1869, after 14 years of sporadic activity from the aforementioned organisations, the Liverpool Association and the London group agreed to form a single permanent organisation that would eventually represent the whole of the building society movement. Led by the more powerful London groups under the chairmanship of James Higham it was named the Building Societies Protection Association. Its rise to being *de facto* central organisation of building societies derived from its activity in the movement for reform of building society legislation, activity that resulted in the passage of the 1874 Building Society Act. In this, it was aided by its journal and mouth-piece, *The Building Society Gazette* which began publication in 1870 and provided a central, popular forum and mode of communication to those in the building society movement.

These are the events leading up the to formation of the Building Societies Protection Association. However, it was the values that it, and its publication, *The Gazette* came to represent, that modified and to a great extent destroyed the original character of mutuality.

Elitism and the BSPA

From its inception the Gazette testified to the unashamed elitism of the BSPA. Whether discussing building society management or the manner in which poorer members should be treated, it readily displayed just how far the building society movement was removed from the *industrious classes* that made up the majority of its membership. In a discussion on the policies to be adopted when a survey was conducted for the purpose of securing an advance, the sensibilities of richer members were considered to be of greater importance than poorer members,

> So long as the operations of a Building Society are confined to the making of advances upon inferior property it may be a matter of little moment whether the privacy of the tenants is invaded by one or two eight or ten persons, visiting for the purpose of a survey but the case is very different when proposals are received upon a better class of property........ It need hardly be contended that as Building Societies advance to a higher class of business than was originally contemplated, it is important to avoid everything in their working arrangements that may prove offensive or annoying.[8]

On the issue of the management of societies, views varied from an attempt to justify elitism on sound business grounds to undisguised snobbery.

On the first point,

> As the society grew older a large proportion of such men would, in the natural order of things, be eliminated from its membership, and thus the management would fall more and more into the hands of men who lacked the necessary knowledge and judgment for the safe conduct of its affairs and who belong exclusively to the borrowing class, had nothing to lose, and to their own sanguine expectations, everything to gain, by a policy which appeared at one state, to cancel shares standing as claims against the society and to increase the assets available for bringing it to an early termination.[9]

And on the second,

> In some few cases it is true that the rules appear to be formed upon the

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[8] Building Society Gazette No.15 p36

[9] p8 Directory and Handbook of Building and Freehold Land Societies (1873) London Office of 'The Building Society Gazette' Chancery Lane

> assumption that all men are equally qualified for the responsibilities and equally entitled to the dignities of office. And every shareholder is consequently permitted or compelled in turn to act as committee man or director; but, excepting societies of the smallest class, assuming rather the character of local clubs than of important financial institutions, any such haphazard theory of management must be dismissed as unworthy of serious discussion. The member selected for this responsible office should a man of good business character, of good practical common sense and of sound and calm judgement.[10]

Or more succinctly,

> It is unquestionably desirable to have men of commanding social position, and of extensive financial resource.[11]

With the social bias of BSA policy in place, it only remained for it to consolidate and centralize its power to spread these policies throughout the whole of the building society movement. This was achieved most notably in the interventionist decades between 1939 and 1980.

During economic depression of the 1930s the lack of demand for money led to increasingly low interest rates. This increased competition between building societies for borrowing members on whom they relied in order to pay high interest rates to lending members. The BSA responded to the impending economic ruin of many of the less competitive societies by annihilating competition itself. This was achieved by a policy of recommending interest rates, to which all member societies, were obliged to adhere.

This policy and power continued unabated for many decades and it was not until the late 1970s that the BSA found itself under much scrutiny. Following two major government reviews, the BSA found itself criticised for centralising power and for engaging in oligargic policies. On the

[10] The Building Society Gazette No.18-1870
[11] BSA Gazette, No.17. Vol. 9 May 1st 1870

first point, the constitution of the BSA was highly undemocratic. In 1983 its membership consisted of representatives from the ten largest societies. Of the representatives who made up the membership, four were co-opted onto the council, and these were drawn from the five largest societies represented in the BSA. These five held 50% of all the capital of the entire industry and the two largest held 33% of the whole.[12] The chairman of the BSA was (and still is) drawn from the largest building society. In other words the largest societies controlled policy in respect of all of the others. [13]

Furthermore, the managers and directors of building societies were, in the view of many on the left of the political spectrum, allowed to operate with no regard to the interests of members and in an unchecked and self-serving fashion. For example, in Paul Barnes's book *The Myth of Mutuality*, he argued that building society managers were dominated by managerial goals like personal prestige, job security, status symbols and empire building. He argued that managers tended to focus upon, 'the non-profit goals of interest groups', and made 'investment beyond those required for the normal operation of the firm'.[14] Indeed, he argued, far from being concerned with profit maximisation, managers viewed profit as, 'the basic constraint subject to which other goals may be followed'.[15]

Barnes argued that a clear example of 'non-profit goals' was the empire building practice of establishing unnecessarily large numbers of building society branches. In analysing the unjustifiably high operational costs of building societies he concluded that in opening branches, managers were not motivated by rational business concerns unless financially constrained to do

[12] P.Barnes (1984) "The Myth of Mutuality" Pluto Press p44
[13] All but 0.1% of building societies were affiliated to the BSA.
[14] ibid p45
[15] ibid

so.

For example, he argued, in 1978, smaller building societies[16], on average spent 76.7p per £100 of assets on operational costs compared to the operational costs of medium-sized societies[17] that on average spent 100.8p per £100 of assets on such costs, the former working under tighter budgetary constraints. Furthermore, Barnes argued that the lack of uniformity in spending on operational costs, across the board, indicated the high degree of discretionary power allowed to managers.

Concurring with this view, Christopher Hird argued that there was little inducement for managers to encourage member's intervention as the former enjoyed enormous power over large financial institutions.[18] Furthermore, he argued, if a member's intervention became noticeable or effective, he or she was quickly co-opted onto the board.

On the second point, the BSA's policy of 'advising' societies on interest rates adopted in 1939, created an informal cartel. As Barnes put it 'firms will collude to fix prices- whether in the sense of a formally constructed cartel, through an informed agreement in a smoke- filled room or simply by a tacit agreement to follow the leader'.[19] And, as an earlier government committee testified, the artificial rate of interest created by the BSA had the effect of supporting inefficient firms and allowing larger, more efficient firms to reap super- profits.[20]

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[16] Defined as those with less than £3,711 million of assets
[17] Defined as those with less that £14,278 million of assets
[18] C. Hird (1997) 'Stakeholding and Building Societies' New Left Review
[19] op cite Barnes p34. Barnes was reflecting the view of the 1966 command paper cited below
[20] CmD 3136 HMSO 1966

Furthermore, the BSA was highly protective of its powers, dealing harshly with members that took business decisions that it (the BSA) had not prescribed. The enforced closure of the New Cross Building Society in 1984, following a decision by the Chief Registrar of Friendly Societies is a case in point. In 1974, Ted Roland became New Cross's chief executive and embarked on some radical departures from the standard practices 'advised' by the BSA. Firstly, the New Cross operated with low management costs, employing just 90 people although during the period between 1975 and 1983 its assets rose from £6million to £120 million.[21] Secondly, three quarters of the society's funds were raised outside their small number of branches. Instead, sales of mortgages were undertaken by a mortgage marketing team and by insurance salesmen. Thirdly, and perhaps most significantly, in March 1993 it took advantage of the generalised sluggish nature of processing mortgage applications (a situation brought about because of the lack of inflow of funds to building societies) to put up interest rates by 2% for its larger and longer- term investors. This meant that it was able to increase inflows of investment and offer quick and easy mortgages at albeit greatly increased interest. It made this move, to its great personal advantage, outside the 'advice' of the BSA on the appropriate rate of interest. Fourthly, and as a result of the products it was able to offer, its customer base was not that of the traditional building societies. As the *Financial Times* reported,

> Few struggling first-time buyers or any other favourites of building society folklore appeared on their mortgage books. Their borrowers included, they claim, international footballers, entertainers and two MP's who were lent amounts of up to pounds 100,000 each, often on properties they already owned.[22]

The Building Society Association responded in this way. A member of the BSA council

[21] Financial Times: "Downfall of a Heretic: Behind the New Cross Closure: Clive Wolman 21 Jan 1984 p24
[22] ibid 24

contacted the auditors of New Cross, Dearden Farrow, and advised them to more carefully scrutinise the 1992-3 accounts. On doing so they found certain discrepancies relating to 'special advances'. Under the 1962 Building Societies Act only 10% of advances may fall under this category, defined as advances to commercial mortgages or mortgages over £37,500. In the New Cross's audits it became clear that this sum had been slightly exceeded. This circumstance arose because a number of mortgages of £37,500 had fallen into arrears thus increasing the amounts owed, technically putting such loans into the 'special advances' category. Although this discrepancy arose through a gray area of law and although there was no evidence of deliberately flaunting Building Society regulation, the Chief registrar, Mr Bridgeton, took the unprecedented step of issuing orders to close the New Cross. Furthermore, he took this decision despite recent precedent to the contrary. For, as the *Financial Times* reported, 'in 1980, the Peckham Mutual Building Society made special advances of nearly double the permitted level, it was let off with a warning'.[23]

Building Societies: The Avoidance of Commercialism

Historical accounts of the political and legal controls over building societies have proceeded along a trajectory that precluded contextual explanations, assessing only those factors internal to the building society movement itself. Whilst this approach dissects a substantial proportion of relevant material, it is incapable of grasping the whole whorled rose of explanation. Assessed comparatively, it is possible to show that building societies were treated in a manner distinct from their more commercial cousins. The effect and the timing of the passage of the 1894 Building Societies Act is a good example of this differential approach.

[23] ibid

The purpose of this section is to set out the account of the passage of the 1894 Act given in the classic texts of E.J.Cleary and Sir Herbert Ashworth. It will then go on to contextualise this account by assessing the political economy at this time and by comparing the building society with the limited company.

Cleary's account of the 1894 Act, like most factual accounts, begins with the Liberator Society. The Liberator Society was founded in 1868 and under the direction of its vice president, Robert Balfour, was, by 1890, the largest building society in Britain. One of the principal reasons for its rapid success was the social connections of Balfour, whose father was president of the Temperance Society. This was one of the central organisations in the non- conformist movement, which accounted for over half of churchgoers, in this period. As well as conveying respectable connotations, Balfour actively used church ministers as commissioned agents for the Liberator.[24] As Cleary notes, in the twenty-four years in which the Liberator operated it paid out £140,000 in commission alone.[25] Furthermore, 'agents were well armed with persuasive literature and, in comparison with most societies, press advertising was considerable'.[26]

The business of the Liberator was largely characterised by large advances to a small number of property developers engaged in the construction of luxury apartments and managed by Balfour. Its main customer was J.W.Hobbs & Company, a company managed by Balfour and found, upon liquidation of the Liberator, to have been advanced £2,099,000 out of total advances from the Liberator of £3,423,000.[27] The Liberator became financially unstable when it could not raise

[24] op cit Cleary p141
[25] ibid
[26] ibid
[27] ibid p142

sufficient funds to pay for the mortgages that the property companies required in order to pay for the properties sold, sometimes directly, by Balfour himself, at vastly inflated prices. They could not do this, and pay dividends from non-existent profits without borrowing still more money from the society. Balfour attempted to keep the Liberator afloat by raising money on existing mortgages by granting second or third mortgages. When one of Balfour's companies, the London and General Bank suspended payments and members seeking to withdraw their investments could not be repaid, confidence in the viability of the society swiftly dissipated. The numbers of anxious investors increased and the society was compulsorily wound up owing over £3,000,000.

The Liberator's crash, according to these accounts, gave rise to the 1894 Act, which prohibited the granting of second mortgages and strengthened the powers of the registrar. It empowered the registrar to have the books of a society inspected following a number of different events; and, under section 4 of Act the registrar could appoint an actuary or accountant to inspect the books, following an application by at least ten members who had been members for at least twelve months proceeding the application and who had agreed to fund the costs of the inspection. Alternatively, under section 5 (1) a registrar could order an inspection following an application of one tenth of the membership, the costs to be borne by the applicants or the society as a whole; or, the registrar could order an inspection without an application by the members if the society has failed to make any return required by the Building Societies Act;[28] or where three members of the society had made a statutory declaration that persuaded the registrar that such an investigation was required.[29]

If it appeared, after investigation, that the society would be unable to meet its obligations to its

[28] Building Societies Act 1894 section 5(5)(a)
[29] Building Societies Act 1894 section 5(5)(c))

members and that, 'it would be in their benefit that it should be dissolved', the registrar could 'award that the society be dissolved'.[30] Furthermore, the registrar could cancel the registration of the society if he was,

> satisfied that a certificate of incorporation had been obtained for a society under the Building Societies Acts by fraud or mistake, or that any such society exists for an illegal purpose, or has willfully after notice from the registrar violated any of the provisions of Building Societies Acts, or has ceased to exist.[31]

Section 13 of the Act specifically prohibited advances on second mortgages and contravention of this prohibition would render the responsible directors, jointly and severally liable for any loss arising from the advance. More generally, the Act provided for a series of fines for officers of the society who did not conform to any rules on the returning of documentation.[32] In addition, it provided that false information in any society document, willfully made would render those officers responsible liable for a fine of up to £50.[33] Finally it stated that any official who received,

> any gift, bonus, commission, or benefit, shall be liable on summary conviction to a fine not exceeding fifty pounds, and, in default of payment, to be imprisoned with or without hard labour for any time not exceeding six months.[34]

These were extensive powers, designed to a great extent to counter the kind of activities that Balfour had engaged in. It is, however, the view of this thesis that the passage of this and other building society legislation cannot be explained by reference to building society history alone.

[30] Building Societies Act 1894 section 7(2)

[31] Building Societies Act 1894 section 6(1)
[32] Building Societies Act 1894 section 21
[33] Building Societies Act 1894 section 22
[34] Building Societies Act 1894 section 23

The government responded to the Liberator's crash with legislation that substantially increased the registrar's powers and introduced more punitive responses to a breach of director's duties when seen out of context, this would appear to be a natural response. However, when viewed in the context of the economy in general it is possible to see that this was not the typical governmental response to financial collapse generally. Indeed, the commercial world had been in crisis for over two decades before the passage of this Act. Britain and its European and American trading partners had been in an economic slump since around 1873, and yet it had not been government policy to tighten controls over other constituent parts of the commercial world.

Depression and Laissez-faire: The Registered Company v The Building Society

Whilst historical opinion is mixed on the issue of the great depression: Karl Marx, explained it as a result of the tendency of the rate of profit to fall due to a shift toward capital-intensive methods of production away from labour-intensive methods,[35] whilst others have denied there was ever an economic decline,[36] statistics point to noticeable economic change. For example, Eric Hobsbawn notes that,

> 21,000 miles of American railroads collapsed into bankruptcy, German share values fell by some 60 per cent between the peak of the boom and 1877 and-more to the point- almost half the blast-furnaces in the main iron producing countries of the world stopped.[37]

[35] The source of value according to social economists such as Marx, David Ricardo and Thomas Hodgeskin

[36] Such as S.B. Saul (1969) "The Myth of the Great Depression" 1873-1896 London

[37] Eric Hobsbawn (1975) "The Age of Capital" p46 Weidenfeld and Nicholson

However, far from responding to this with increased control over the commercial world, government and judicial policy tended toward the opposite. For example, by 1897 the courts were extending the benefits of limited liability and corporate status to businesses that were effectively one man companies; involving one man who was the sole employee, sole director, sole secured creditor[38] and virtually sole shareholder. As Lord MacNaughton famously noted,

> The company attains maturity on its birth. There can be no period of minority- no interval of incapacity. I cannot understand how a body corporate thus made capable by statute can lose its individuality by issuing the bulk of its capital to one person, whether he be a subscriber to the memorandum or not. The company is at law a different person altogether from the subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the way it was before, and the same persons are managers, and the same hand receives the profit, the company is not in law the agent of the subscribers or trustees for them.[39]

Furthermore, judicial attitudes to the duties owed by company directors softened throughout the latter half of the nineteenth century, as did the responsibilities of the company owners. Prior to the 1844 Joint Stock Companies Act,[40] companies, as previously noted were obliged to operate as Deed of Settlement Companies or gain an Act of Parliament or Charter, in order to avoid the penalties of the Bubble Act. In Deed of Settlement Companies, directors were invariably trustees who held the title to the company for the beneficiaries, the shareholders. As trustees, directors owed a high level of care to the company and, as beneficial owners, shareholders had an interest in the companies assets but also (unless there was an agreement in the deed to the contrary) undertook unlimited liability for the company's debts.

The historical development of the company form, facilitated by legislation such as the Limited

[38] Later in the company's life Mr Broderip became a secured creditor.
[39] Salomon v Salomon & Co. (1897) AC 22
[40] 7&8 Vict c.110&111

Liability Act 1855, continued throughout the period of economic depression. The evolution of the company had the effect of affording shareholders all the benefits of ownership without any of the responsibilities.[41] So, whilst the doctrine of separate corporate personality meant that the shareholder did not own the physical assets of the company, 'neither a shareholder nor a simple creditor of a company has any insurable interest in any particular asset of the company'[42] they did own title to dividends and other residual rights of ownership such as voting rights. A shareholder remained the owner, by dint of owning a *function* of the company, that of making profits.

This benefit (dividends) coupled with the maintenance of voting rights was now unhampered by the responsibility of personal liability for company debts. Likewise, now that the assets of the company were deemed to be owned by the company, title was vested in it and not in the directors. The directors could not, therefore, be capable of being trustees and so owed a lesser duty to the company, that of an agent. In addition to this, the judiciary translated this duty as being owed to the 'company', which was understood to mean shareholders as a whole[43]. Making profits, the interests of the shareholders, was deemed to be of greater importance than the protection of company assets, that portion that protected creditors.[44]

Furthermore in respect to the degree of care and skill a director was obliged to bring to bear upon

[41] Limited Liability Act (1855) 18 & 19 Vict c.133
[42] The view taken of shareholders ownership rights in Macaura v Northern Assurance Co Ltd. [1925] AC 619. The process of separating company property from shareholder property was a process that began with large companies. By the end of the century this conception was regarded as correct regardless of the size of the company.
[43] Percival v Wright [1902] 2 Ch. 421
[44] As Farrar points out the, "obligation to act bone fide in the interests of the company has been defined as an obligation to act in the interests of the shareholders." Farrar's Company Law 4th Edition p381

his duties, the judiciary were prepared to tolerate high levels of incompetence in the company directors. In assessing nineteenth century judgments, the court held that the duty required from a director was not the common law duty of care of the reasonable man but was better described as an equitable duty, analogous to a trustee. In Re City Equitable Fire Assurance Co. Ltd a director's duty was encompassed by three basic propositions.[45] Firstly, a director was expected to exercise no greater care or skill than that expected from person of his knowledge and experience, a subjective test. Secondly, there was no requirement that a director should give his full time and attention to affairs of the company. And, thirdly, where management was properly delegated, a director was justified, in the absence of grounds for suspicion, in trusting an official to perform his duties honestly. Again, in Farrar it is noted that, 'the courts regarded directors as pleasant, if sometimes incompetent, amateurs who did not possess any particular executive skills and upon whom it would have been unreasonable to impose onerous standards of care and skill'.[46]

In contrast, the judiciary has tended toward a less liberalised attitude to the duties owed by a director to his building society although at first blush they may appear identical. Wurztburg, for example, maintains that there is no real distinct legal status for the building society director and that in general terms,

> The position of the directors of a building society is substantially the same as that of directors of an ordinary joint-stock trading company, that is to say, they are not trustees, but paid confidential agents, with very extensive powers selected to manage the affairs of the society for the benefit of themselves and other shareholders.[47]

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[45] [1925] Ch 407

[46] op cit Farrar p392

[47] Wurtzburg (1892) The Law Relating to Building Societies p92 2nd edition

Wurtzburg further argued that the description of a building society director's duties are properly described in the case of Faure Electric Accumulator Co,[48] which in assessing the duties owed by a company director stated that,

> It is quite obvious that to apply to directors the strict rules of the court of chancery with respect to ordinary trustees might fetter their action to an extent which would be extremely disadvantages to the companies they represent.[49]

And,

> Directors being in the position of agents[50] for their company are bound, like any other agents, to use the same degree of diligence which persons of common prudence would use in their own affairs.[51]

However, although directors of building societies were similarly detached from the incorporated entity, the duty that they owed to the entity was greater because of the greater responsibilities attached to a prudential organisation. For example, in respect of liability for the payment of non existent profits to members by directors, the directors of building societies operated under a much more stringent regime. In a case bought by the Leeds Estate Building Society against one of its directors it was held that directors who pay dividends to themselves and shareholders out of illusory profits, on the basis of inaccurate balance sheets which they did not properly examine, were personally liable for the sums paid out and were required to recompense the society accordingly.[52]

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[48] (1888) 40 Ch.D

[49] ibid p151

[50] The main reason for this description is that unlike a trustee, a manager of an incorporated company with a separate legal personality does not have title to company property vested in himself. Instead, title to company property, as previously noted, is vested in the company and no person involved in the company has any claim to the assets of the company until the company enters liquidation

[51] ibid Sir Horace Davey Q.C.

[52] Leeds Estate Building and Investment Co. v Shepherd, 36 Ch.D 787.

In contrast, the duty imposed on company directors was much less onerous, mainly due to the judicial tendency to interpret statute in a manner sympathetic to commercial directors. So, although directors during this period operated under some restrictions in respect of the payment of dividends, for example Clause 73 of table A stated that 'no dividend shall be payable except out of profits arising from the Business of the Company', this restriction was highly modified by the judiciary's liberal interpretation of profit. In an 1880 case, Lord Jessel concluded that when assessing the legality of dividends, the court need not consider capital losses from previous years. In this case a tramway company had failed to maintain company assets, or to set aside a maintenance fund, notwithstanding that the articles stated that the directors should, 'before recommending a dividend, set aside out of the profits of the company.......such sums as they think proper as a reserve fund for maintenance, repairs, depreciation, and renewals'.[53] As a result of their failure to do so, an injunction was granted against the company's declaration of a dividend. In response, an action to dissolve the injunction was successfully brought to court by a preference shareholder where, importantly, the pertinent question for the court was not whether the value of the assets had diminished, or indeed whether the failure to observe the articles should be rectified, but, whether or not there were sufficient profits made *that year* to pay dividends. If there were then a dividend could be paid.

Likewise, in a case immediately proceeding the classic case Trevor v Whitworth which established the capital maintenance rule that a company could not buy back its own shares, the Court of Appeal stated that,

> it is entirely with the shareholders to decide whether the excess shall be divided

[53] Dent v London Tramways Company (1880) 16 Ch.D 344 quoted on p348

> among them or set apart as a reserve fund for replacing assets, and the court has no power to intervene with their decision however foolish or imprudent it may be.[54]

Even in the context of the Trevor case, Lord Watson commented that, 'paid up capital may be diminished or lost in the course of trading, that is a result which no legislation can prevent'.[55] For the Companies Act had made only one restriction, and that was that no dividend could be paid except out of profits. The protection of assets that might diminish in value in the pursuit of these profits was not within the ambit of the Company Acts, so, in Lee v Neutchatel Asphate Co. it was held that, 'there was nothing in the Companies Acts .....to impose on the company any obligation to set apart a sinking fund to meet the depreciation in the value of a wasting product'.[56] Furthermore, it emphasised that the power to restore wasting assets lay not with the creditors, who relied on the assets as security, but with the shareholders, whose sole economic interest lay in dividends. The problems for creditors were further exacerbated by the court's failure to find an adequate definition of profit, making the funds designated available for the payment of dividends ultimately a movable feast.[57] This approach to accounting practice was not available to building societies as they were obliged to show an equal balance between liabilities and assets in order to adhere to the mutual principle.

Further responsibilities placed upon building society managers included a statutory requirement to give security to the society for the monies they managed with their own personal funds.

> Every officer having receipt or charge of any money belonging to the society must, before taking upon himself the execution of his office, become bound with

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[54] Lee v Neuchatel Asphate Co. (1889) 41 Ch D 1 quoted on p10
[55] Trevor v Whitworth (1887) 12 App Cas 409
[56] Lee v Neuchatel Asphate ibid p1
[57] Joseph Weiner (1918) "The Theory of Anglo-American Dividend Law: The English Cases" Columbia Law Review

> one sufficient surety at the least, in a bond according to the form below or give the security of a guarantee society, or such other security of a guarantee society, or such security as the society direct, in such sum as the society require, conditioned for rendering a just and true account of all moneys received and paid by him on account of the society, at such times as its rules appoint, or as the society require him to do. [58]

Failure to comply would make directors, 'clearly liable for any loss resulting from its non performance'. [59] As Wurtzburg noted, upon demand, all officers were to account to the board and pay over 'all moneys remaining in his hands; deliver all securities and effects, books, papers, and property of the society in his hands or custody, to such person as the society appoint'.[60] An officer who failed to comply with such a request could be sued by the society upon the bond or it could apply to the county court to make an order against him, against which there was no appeal. Furthermore, a dismissed officer could be ordered to return any society property regardless of whether the dismissal was wrongful and against which there was no appeal. Internal to the building society movement, as previously noted, the Building Society Association required its managers to be men of upstanding social position and to be of financial substance.

Other extrinsic influences which contributed the greater controls placed over building society directors included the strict application of the *ultra vires* rule. For instance, the statutory object of a building society, that of making advances to members secured upon freehold or leasehold from funds raised from investing members, remained unchanged for over one hundred years. A society was bound to these objects and was prohibited from extending its business by making changes to its own rules or by any other method.[61] In Portsea Island Building Society v

[58] Building Societies Act 1874 section 23
[59] Evans v Coventry 8 De G.M. & G. 835; L.J.Ch.400
[60] Wurtzburg ibid p88
[61] Murray v Scott (1884) 9 App. Cas. 519

Barclay,[62] the society' directors made a further advance to an existing mortgagee by applying to an insurance company for a loan and then paying this sum to the borrowing member in consideration for the conveyance of the mortgaged property to the society. The society agreed to postpone their own mortgage to the insurance company's rights and the deeds to the mortgaged property were deposited with the insurance company as security for the loan. The member then used the loan to repay part of the original mortgage. The rules of the society forbid any advance on an equity of redemption but authorised the directors to release part of any mortgaged property if it was satisfied that the remainder was sufficient security for the loan. The court held the transaction to be *ultra vires* and void. Any departure from the objects of a society instigated or allowed by the directors would be a breach of duty and would render them liable for any loss that might result.[63]

Statutory and common-law restrictions meant that there was little room for extending the societies' capacity thereby limiting the situations when an ultra vires act might arise. In contrast, the *ultra vires* rule in relation to companies, though strictly applied in the early cases become increasingly loosened. For example, in Ashbury Railway Carriage & Iron Co v Riche,[64] a company incorporated under the Companies Act 1862 stated as its objects 'to make, sell, lend or hire, railway carriages, wagons plant machinery etc'.[65] Whilst Clause 4 provided that 'an extension of the company business beyond or for other than the objects or purposes expressed or implied in the memorandum of association shall take place only in pursuance of a special resolution'. The House of Lords declared a contract to finance the construction of a Railway in Belgium to be *ultra vires* and void. Furthermore, it stated that ratification would have been

[62] (1894) 3 Ch.861

[63] Cullerne v London and Suburban General Permanent Building Society (1890) 25 Q.B.D. 485

[64] 1875 LR 7 HL 653

[65] Clause 3 of the memorandum

ineffective and incapable of rendering the company able to do something that wasn't strictly in the ambit of the objects.

> Where a company is formed on the principle of having the liability of its members limited to the amount unpaid on their shares......the memorandum of association shall contain.....the objects for which the proposed company is to be established.....and the existence and the coming into existence , of the company is to be an existence and to be a coming into existence for those objects and for those objects alone.[66]

However, just five years later the courts began to take a more lenient view. In A-G v Great Eastern Railway Co.[67], a company incorporated by statute to acquire two existing railway companies and to construct another, wanted to hire locomotives and stock to another company. The court decided that this contract would not be *ultra vires* as it was reasonably incidental to the main objects.

Later, the judiciary began to take a more lenient attitude to the construction of the objects clause. Whilst in an earlier case[68] the court declared that a company had failed to achieve the business for which it was incorporated by reason that it not attained one of the clauses (upon which all the other objects were said to be ancillary), by 1918 the courts accepted a clause making each separate object in each sub-clause an equal and independent object.[69]

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66 op cit judgment p665
67 (1880) 5 App Cas 4731
68 Re German Date Coffee Company. (1882) ch20 169
69 Cotman v Brougham (1918) AC 514 Essequibo, was a rubber company with a long objects clause that ended with a clause that the objects should not be restrictively construed and that each paragraph should be regarded as conferring a separate and independent object. Each clause was held to be substantive and not subsidiary to the object. It underwrote an issue of shares from an asphalt company. Later, when both companies were in liquidation the liquidator sought an application to render the transaction ultra vires. The court said that the validity of the clause could be upheld, it was not ultra vires and the memorandum had been correctly compiled and should be construed literally.

By the 1960s the courts went as far as to accept the validity of a subjective objects clause. In Bell Houses Ltd v City Wall Properties Ltd, the court upheld the validity of a clause that empowered the plaintiff company to,

> carry on any other trade or business whatsoever which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with or as ancillary to any of the above businesses of the general business of the company.[70]

Furthermore, despite judicial antipathy to companies making non-commercial payments, famously encompassed in the statement that, 'there shall be no cakes and ale except such as are required for the benefit of the company', it developed an increasingly tolerant attitude to gratuitous payments.[71] Firstly, the courts upheld payments that were *bone fide* for the benefit of the company and reasonably incidental to the business, where there was an express clause allowing the company to make gifts. In Evans v Brunner Mond & Co.[72] the plaintiff, a shareholder, challenged the decision of the company to distribute to universities and scientific institutions the sum of £100,000 in furtherance of scientific education. A resolution authorising this distribution had been passed by an overwhelming majority of shareholders, however, he argued that the motion instituted an activity that was not incidental to the company's business and was not for the benefit of the company. He argued that the rightful beneficiaries of the money would only benefit to a very small degree whilst the cost of the gift to the company was very great. The court, however, upheld the gift saying that as the company was,

> in constant need of a reserve of scientifically trained men for the purposes of its

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[70] (1966) 1 QB 207
[71] Hutton v West Cork Ry Co. (1883) 23 Ch.D 654
[72] (1921) 1 Ch 359

> business- and the business cannot be maintained if the supply of such men is deficient- that a deficiency is almost inevitable unless substantial inducements are forthcoming to attract men to scientific study and research men to scientific study and research- that the best agencies for directing these studies are well equipped universities.[73]

Later, the courts showed even greater latitude by allowing a payment that was not necessarily incidental to the company's business or for the benefit of the company, on the basis that non-commercial clauses would be upheld.[74]

In all areas of commercialism, *laissez faire* was the *modus operandi.* As Eric Hobsbawn noted, 'the formation of business companies now became both considerably easier and independent of bureaucratic control.........Commercial law was adapted to the prevailing atmosphere of buoyant business expansion'. In order to further enhance business expansionism the stringent laws against usury were dropped in Britain, Holland, Belgium and North Germany between the years of 1854 and 1867. Likewise, 'the strict control which governments exercised over mining - including actual operations of mines- was virtually withdrawn......so that.... any entrepreneur could claim the right to exploit any minerals he found'.[75] In order to enhance a freer market in labour, the Master and Servant Acts were repealed in 1875 as was the 'annual bond' of the North[76] so that, 'in between 1867 and 1875 all significant legal obstacles to trade unions and the right to strike were abolished with remarkably little fuss'.[77]

In contrast, as this thesis has demonstrated, the political and judicial attitude to building societies

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[73] ibid p369

[74] Re Horsley & Weight Ltd (1982) 3 All ER 1045

[75] Eric Hobsbawn "The Age of Capital 1848-1875" (1975) p37

[76] Applicable to miners in the North. This was replaced by a standard employment contract, terminable on both sides.

[77] ibid p37

was quite distinctly non *laissez-faire*. This was partly due, as has been argued, to the desire to maintain and control institutions that so readily attracted the independent 'industrious classes', and incorporated them into mainstream society, a view consistently evidenced by the commissioners in the 1870's. Integral to this approach has been ensuring the security of investments in societies and much of the emphasis of building society legislation has attempted to achieve this. So, for example, the Building Societies Act 1939 prohibited advances made on securities that were not of a class specified in Part 1 of the Schedule to the Act, that is, advances made on freehold or leasehold land.[78] And, under section 6 of the Act, such advances were to be repaid over a period not exceeding twenty-three years. Directors were under a duty to ensure that adequate measures had been taken to ascertain the proper valuation of property upon which a mortgage would be advanced and the test of competency in this case was objective. A director should ensure that,

> the arrangements made for assessing the adequacy of a security to be taken in respect of advances to be made by the society are such as may reasonably be expected to ensure the adequacy of any security to be so taken will be assessed by a competent and prudent person, experienced in matters relevant to the determination of the valuation of that security.[79]

Directors were additionally required to keep prescribed records of advances, including records of a competent valuation.[80] Failure to do this would constitute a summary offence, resulting in a fine.

Another area of security assurance included provisions for maintaining minimum reserves.

[78] BSA 1939 section 2 (1) The basic advance was set at seventy-five per cent of the value of the property section 2 (4)
[79] BSA 1939 section 12 (1)
[80] BSA 1939 section 12(3)

Larger, permanent building societies had routinely held surplus profits as reserves for the purpose of enhancing financial security and thus achieving trustee status under the Designation of Trustee Status Regulations. Ultimately these were held on trust for the owner-members (creditors had priority over this fund). In 1947 the Building Society Association recommended a 5% reserve ratio and four years later a 7.5% minimum liquidity ratio.[81] In 1959, The House Purchase and Housing Act introduced a minimum reserve ratio of 2.5% and a minimum of 7.5% liquidity ratio, (assets were required to be a minimum of £0.5 million). The 1962 Building Society Act removed the requirement for a minimum liquid assets (still necessary to achieve trustee status) but stated that,

> A building society shall not invest any part of the surplus funds of a society except in a manner authorised by an order made under this section by the chief registrar with the consent of the treasury.[82]

In 1981, the Building Societies (Authorisation) Regulations made authorisation for the raising of funds dependant on the holding of reserves. This was compulsory for all societies but, the level of reserves would depend on the size of the society. All societies were obliged to hold at least £50,000 as reserves and those with up to £100 million of assets were required to keep 2.5% of this as reserves. A society with between £100 million and £500 million in assets was required to keep 2% of its assets as reserves. This percentage went down to 1.5% for societies with assets worth between £500 million and £1,000 million, with a further reduction of 0.25% for those societies with assets exceeding £1,000 million.

The aim of all the above measures was to achieve one objective, the production of a prudential framework. However, the hoarding of reserves ultimately enabled the argument against

[81] Mark Boleat (1986) The Building Society Industry 2nd edition p146
[82] Section 58 (1) Building Societies Act 1962

maintaining mutual status to be submerged under the benefits of the short term gains provided by windfall shares, as will be suggested in chapters four and six.

Conclusion

It is submitted that the emergence of a commercial institution, the mutual society, that was unique in collecting additional controls over its activities throughout a historical period of liberalisation or *laissez-faire*, was due as much to external political control as to factors internal to the building society movement itself. Early building societies ensured their insulation from the government's draconian anti-collectives policies by adhering to strict internal controls and a non-provocative attitude. Success and expansion in the mid-nineteenth century led to the introduction of an organisational form, the permanent society, that required both responsibility and expertise from its officers, and those active in the movement sought controls to ensure that this happened. Furthermore, the permanent societies' reliance on investors, who might have no stake as a borrower, meant that legislative controls were sought to ensure the security of the lender-member's investment. Significantly, this put borrower members under scrutiny and led to building societies introducing rigid lending criteria with a borrower profile that excluded all but white middle class men. In addition to this, reserves designed to protect investors created a fund which could and would be used by ambitious building society directors in order to effect a conversion.

Chapter 4

Neo- Liberalism and Mutuality

1. Introduction and Political context
2. Parliament, Policy and Mutuality: The Making of the 1986 Building Society Act
3. The Thatcherite Approach "Building Societies: A new Framework"
4. Conclusion.

> We are sending this pristine maiden, the building societies, out into the financial jungle where dangers abound and rapists throng. Why in any sense, loosen the lock on the chastity belt? Austin Mitchell MP[1]

Introduction

The purpose of this chapter is to assess the effect of the Thatcher administration and Neo-Liberalism generally on mutuality in building societies. It argues that the culmination of a number of conflicting social and political factors led to the passage of a radical and far- reaching piece of legislation,[2] which, in itself, encapsulated these contradictions. Economically, building societies had developed into organisations that were criticised by the political left for being oligargic and by the radical or New Right for being interventionist, social and for operating contrary to the 'free market'. In contrast, traditional Conservatism and welfare Labourism favoured the social benefits offered by mutual building societies and thus favoured the protection of their privileged and distinctive status. However, the political weight behind these perspectives were not evenly matched as the economic and political effects of the previous decade had laid the foundation for the emergence of a strong, reconstituted Conservative Party, whose ideology has been subsequently dubbed, the New Right or Neo-Liberalism.

As Stuart Hall so aptly describes, the emergence of this reconstituted Conservative party can itself be explained and understood by assessing the contradictions inherent in British society

[1] Hansard 1985 Debate on the Building Societies Bill p945
[2] The Building Societies Act 1986

prior to their electoral victory.[3] The two primary contradictions in British society lay in the demands of the market economy and in the policy responses of the Labour government. Engulfed in recession, a backlash to the initial post war boom, the social democratic Labour Party could not maintain credibility as the party of the working class whilst requiring this same class to conform to the constraints of a capitalist crisis.

Throughout the 1970s it was Callaghan's Labour government that introduced the harsh monetarist policies advised by the IMF, and it was this same government that slashed spending on the welfare state. Ironically, when these policies were re-adopted by the new Thatcher government, they were heralded as responsible, innovative and liberating. But, in the hands of the Labour government, they were seen as treacherous and authoritarian. Labour, popularly viewed as the party of the working class, discovered that all ideological initiatives to liken the interests of workers to the success of capitalism, initiatives that Hall characterises as 'corporatist....,incorporating sections of the working class and unions into the bargain between state, capital and labour', floundered.[4] The contradiction within this political approach to the economic crisis lay, argued Hall, in Labour's inability to appear to represent the people it governed. Instead it appeared to betray the class it represented, who responded by participating in huge industrial unrest. Unjustly so, argues Hall as,

> "Labourism'- is not a homogenous political entity but a complex political formation. It is not the expression of the working class 'in government', but the principal means of the political representation of the class.[5]

However, in the context of the 1970s, Labour's policies could not convey the same clarity of

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[3] Stuart Hall 'The Great Moving Right Show'
[4] ibid p24
[5] ibid p26

vision that the New Right and subsequently 'Thatcherism' was able to do. The New Right was able to capitalise upon Labour's political dilemmas by treating popular perceptions of Labour as an authoritarian government, as a reality. Ideologically, Thatcherism linked social welfare policies with intrusive anti- individual state activities, neatly disassociating itself from both.

The New Right side-stepped the issue of being a party representing a particular class interest and instead, advanced what Hall calls a 'people to party' approach. It represented the nation, whilst the Labour Party represented class interests and, in so doing, had needed to create an interventionist and controlling state. The New Right's populist approach was encapsulated in anti state rhetoric such as the abolition of the 'nanny state' that both encouraged scroungers and stifled entrepreneurialism. In the context of interventionist Labour policies, argues Hall, this rhetoric was a covert and highly successful attack on Labour and social democratic politics generally.

Intellectually, the New Right's rhetoric drew from the more classic articulations of liberalism. Intellectuals such as Adam Smith, John Stuart Mill and, in particular, Hayek were drawn upon as masters of common-sense for their reasoned antipathy to state intervention and their association of *laissez faire* policies with individual liberty and economic progress. Hayek was especially acute on this point, writing, as he was, in the aftermath of fascism. Hayek directly associated a thriving dynamic economy with a minimalist state that was underpinned by the rule of law. An interventionist government, one which controlled the economy rather than allowing a market of contracting individuals to operate freely, was necessarily arbitrary and discriminatory. Such a government could not function under a legal system whose rules were, 'fixed and announced beforehand', it required flexibility to respond to circumstances as they arose, unencumbered by a priori legislation. [6]

Legislation passed by an interventionist government, therefore, was merely the expression of party politics and involved rules with a substantive content, designed to achieve a particular end. Under an interventionist government, individuals could not rely on a known status quo and could not predict the actions of their State. In order to achieve self-expression and economic growth, individuals required a system of pre-set, formal rules under which all, including government, were subject. With such a system individuals could, 'predict actions of the state which may affect these plans'[7]and only under these conditions could a free market operate. For Hayek, it was only the rule of law that could prevent government undermining individual property rights and suppressing individual effort, two key elements of the allegedly entrepreneurial spirit much vaunted in the 1980s.

A society of individuals pursuing their own economic objectives within 'formal and generalised' rules, gave rise to what Hayek called a 'spontaneous order', or what Adam Smith similarly called 'the invisible hand of the market'. And, later in, *Law, Legislation and Liberty*,[8] Hayek expanded his theory on the dynamic character of spontaneous order, justifying it on the basis that as individuals possessed better local information than the state and possessed a self-interest in making use of it, an economy based on individual self-interest, a free market, would be bound to thrive. Individuals possessed the most accurate knowledge of their own circumstances, local resources and potential for growth and profit making. And, unlike the State, it was the individual who had access to the most precise and up to date 'decentralised' and 'fragmented' knowledge, and it was the individual who had the greatest self-interest in making use of this knowledge

[6] F. Hayek (1976) Road to Serfdom p56 London. Routledge, Kegan and Paul.
[7] ibid
[8] F.Hayek (1979) Law Legislation and Liberty

toward the furtherance of his own enrichment and ultimately the enrichment of society as a whole.

Centralised planning, however, stymied the intrinsic power of the individual, disabling him from taking full advantage of his unique position. 'Hence the familiar fact that the more the state plans....the more difficult planning becomes for the individual'.[9] According to Hayek, a planned economy, although dressed up as creating the greater human good, encouraged discrimination, and suppressed creativity and freedom, a perspective on which the New Right hungrily fed. Thatcher's government drew from this language of liberty and identified its attainment with the restriction and reduction of the machinations of the state.

Individual private property was central to the New Right's attack on post war welfarism. In an ingenious conjunction of its anti-state welfare ideology and that of individual private property, council houses were sold to their occupants, taken from council control and transformed into the private property of former council house tenants.

Philosophically, the orientation of the rule of law around the protection of private property, maintained by liberal thinkers from Locke to Hayek, is justified on the basis that these individual rights act as a buffer against the intervention of the state. Freedom, formal equality and private property are, for liberals, intrinsically connected by, '....... recalling the link ......between having a property in one's person and being a free man'.[10] It is the freedom of the individual to sell their personal skills and strengths in the market for a price determined by market forces that is the starting point for the ascendance of private property. Thus,

[9] F Hayek (1944) The Road to serfdom p57
[10] Gray, J (1995) "Liberalism " p58 Open University Press

> having this most basic right in my own person seems to entail having the most basic of liberal freedoms- contractual liberty, liberty of occupation, association and movement and so on- and it is compromised whenever these freedoms are abridged. The connection between property and the basic liberties is in these cases constitutive and not just instrumental.[11]

For modern liberal thinkers it is the subservience of private property rights in person and things to the dictates of collectivism and the state that create a situation where,

> ... we move away from private property to communal or collective institutions, (and) the practical knowledge available to society is diluted or attenuated.[12]

Under collectivism, the individual is constrained by the values of others. The result according to Grey is that, 'Communal systems of ownership embody a bias against risk and novelty- a fact which may go far to explain the technological stagnation of the world's socialist economies'.[13]

The New Right, therefore, were adverse to the notion that private industry should be constrained by public or non economic criteria. Interference with the spontaneous order of the market was akin to socialism and all its accompanying evils. Thus, when the *Committee to Review the Functioning of Financial Institutions* appointed under the premiership of James Callaghan but published in 1980 under the government of Margaret Thatcher, noted that, 'criticism (of company policy) by small-scale shareholders or by financial journalists constrained as it is by the laws of libel, can frequently be ignored',[14] the New Right's response was to do nothing. Instead of introducing policies that would redress this balance of power, its response was to allow the

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[11] ibid p63
[12] ibid
[13] ibid p65
[14] "Committee to Review the Functioning of Financial Institutions" (1980) p249

market, in this case majority- shareholders, to retain its hegemony. Likewise, the Bullock Report's recommendation of shareholder and employee representation on the board of directors in order to kerb, ' the substantial degree of independence from outside control'[15] they enjoyed, was legislatively expressed in the toothless section 309 of the Companies Act 1985 which states that, 'directors of a company are to have regard in the performance of their functions....the interests of the company's employees in general, as well as the interests of its members'.

Labour's vision of the company as an inclusive and socially responsible institution driven by concerns other than profit, was not shared by the New Right and, problematically, these were the very principles upon which mutuality was based. Historically, the mutual building society was an institution that been, in many ways, socially engineered in order to reify the rewards of thrift and hard work to working people. In the, albeit partisan, words of Sir Herbert Ashworth, former chairman of the Nationwide Building Society, 'they are admirable institutions which have made a significant contribution to the welfare of the people of this country by fostering saving and promoting home ownership'.[16] No mention of profitability here.

The Conservative Party wished to portray itself as a non- interventionist government presiding over a free market which emphasised individualism and the regressive nature of welfarism, and in so doing it reasserted nineteenth century liberal philosophy. Yet, within the new Conservative administration's classic reconstruction of the liberal notion of a social order based on the desires and choices of isolated abstract individuals, lay an internal contradiction. Whilst freeing the market from what were mainly welfare spending constraints relied on liberal justifications, overcoming the inevitable social fallout required the more controlling elements of classically

[15] The Bullock Report
[16] H.Ashworth (1980)'Building Societies Story' preface. London. Franey

conservative ideologies. The 'Salisbury Review', intellectual mouthpiece of the Conservative Party, consistently reflected this contradiction. The New Right embraced liberalism to the extent that it could be detached from its association with moral libertarianism or modernism.

In Norman Barry's piece of July 1987, this contradiction is justified on the basis of the internal inadequacy of liberal philosophy itself. Liberalism, he argued, relied on a subjectivist understanding of social reality. Whether, (taking the broad spectrum of liberal thinking) the notion 'human nature' was constructed on given precepts or based on empirical data, it was given and immutable. Therefore, he argued, any society that emerged from the interaction of these *a priori* human natures was beyond criticism as it merely reflected the unrepressed will of separate individuals. Such, 'a subjectivist epistemology justifies any form of political order, provided that it can be said to emerge from human choice'.[17] In contrast, he argued, the conservative philosopher possesses an objective understanding of social realty,

> The structure of a political order is not something designed or chosen but something 'given' (or perhaps more accurately, received); it is a 'form of life' which contains within itself the values which sustain a social order.[18]

As society is a given, an entity which emerges from accumulated traditions and beliefs, it is not possible for an individual to fully analyse it let alone reduce it to merely the accumulation of individual desires, it is 'metaphysically impossible to stand outside this pre-existing order and appraise it from the perspective, say, of the market or of subjective choice'.[19]

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17 Norman Barry (1989) "Conservatism, Liberalism and Modernism" A Reply to Anthony O'Hare p22 July

18 ibid

19 ibid

A conservative, argues Barry, understands that the free market is insufficient to maintain order or to provide even the most basic ethical guidance. Liberalism's cash nexus understanding of human behaviour is insufficient to explain or justify public or altruistic acts. The reduction of all human behaviour to the pursuit of individual desires becomes absurd, for example, when one attempts to apply it to marital or parental relationships. Liberal and free market activities, as popularised by Thatcherism, therefore may only operate upon traditional, often irrational and invariably oppressive social institutions. As Peregrine Worsthorne, conservative journalist argued, a society stratified by class, which gives privileges to one strata over another, is perhaps not fair or meritocratic but does have the advantage of being a caring and stable society.

> In a class ridden society those who do not rise need have no sense of failure because they never had all that much of a chance of success. The cards were stacked up against them from the start. Little blame or shame attaches to them: only to the system.......But in America, where each man is free to determine his own rank, there is much more cause for pride and shame and, there being no great class divisions keeping the successful and unsuccessful apart, the resulting frictions and resentments have all the additional bitterness that only proximity can provoke.[20]

During the 1980s, classic conservatism maintained a tentative relationship with the new Conservative Party, a contradiction that was never resolved. So, for example, in reflecting upon eight years of Thatcherism, E.J.Misham lamented the huge social costs resulting from an economic policy based on the partial adoption of the new monetarism espoused by the Chicago School's Milton Friedman. Friedman advocated 'balanced budgets, rejected all direct controls, and even disavowed the direct use of interest rates', with the aim of, 'expanding the money supply by a fixed annual percent in order to maintain the broad trend of prices as real output increased over time'.[21] The Thatcher government adopted this market policy in relation to labour

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[20] P. Worsthorne. 'The Cruelty of a Classless Society'- Sunday Telegraph 31 may 1992

[21] Both quotations: E.J.Misham. "One Cheer for Mrs Thatcher's Economic Achievement"

but maintained some control over interest rates and the money supply in order to achieve low inflation. Problematically, argued Misham, this has led to a reduced and highly mobile workforce with the 'contrived indispensability of the private automobile', and a huge increase in crime.[22] The economic prosperity, achieved at the expense of mass unemployment, an increase in the budget deficit and the erosion of welfare, has merely resulted, argues Misham, in the emergence of cheap popular culture, 'the vulgar, the violent, the obscene, and the sexually explicit'.[23] In short, the emphasis of market ideology and the erosion of long standing social order (modernism) in the name of progress, 'has fostered a predominately secular and hedonistic society, one bereft of transcendental faith, uncertain of the distinctions between right and wrong and increasingly reluctant, therefore, of making moral judgments'.[24]

In the same journal, Ian Crowther's piece on Thatcherism, vividly articulated the contradictions inherent in the New Right. He argued that capitalism is 'morally neutral' and that the historical coincidence of industrial capitalism with Victorian morality does not make the two natural and inevitable companions. This coincidence in the nineteenth century meant that the free market could flourish under cultural traditions emanating from different socio-economic circumstances, '*noblesse oblige*, in part from middle-class ideas of respectability, and in part from Church and Chapel'.[25] In the absence of this or any other powerful social system, a free market society will merely reproduce competitive, selfish and anti-social tendencies in the non economic sphere, a happenstance, argued Crowther that explains the rise of violent crimes, divorce and child abuse. Although, at root, he blames the social democracy that proceeded Thatcherism for the breakdown of social structures, because the notion of 'collective responsibility fostered a

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Salisbury Review, September 1989, p14-15

[22] ibid p18

[23] ibid

[24] ibid

[25] I. Crowther (1989) p5, SR, September 1989, ' Thatcherism and the Good Life'.

diminished sense of personal responsibility',[26] the New Right' failed in that it did not introduce new moral and social systems into the vacuum.

In Crowther's words,

> many in Mrs Thatcher's government seem so entranced by the businessman's ethic of profit- what is euphemistically described as the 'discipline of the market'- that they regard talk of any other ethic as a form of hypocrisy: a rhetorical mask for vested interests. Either that, or they do quite sincerely believe that non-economic ideals will somehow live on, ghost like, long after the extinction of the professional and public bodies that have nourished them.[27]

The context, therefore, in which building societies and hence mutuality were both politically debated and legally reconceptualised was one characterised by a number of contradictions. The government of the New Right was ideologically opposed to state intervention in the 'natural' running of the free market. The economy, they considered, should not be guided toward social or policy based conclusions but should function as a mechanism for individuals to pursue self-interest and to enjoy full reward for their industry. From this perspective, the idea that financial institutions or corporations should operate as social institutions, aided, directed and controlled by government was a total anathema. Thus, the privileges and constraints under which building societies operated would seem to be prime for liberalisation, introducing the mutuals to the norms of the free market.

However, the government of the New Right had emerged from a party for whom the conservative ethos of order, social hierarchy, patronage and tradition remained. Indeed,

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[26] Ibid p4
[27] ibid p5

'Thatcherism' itself accepted the inevitability and even the desirability of a class society, although it generally rejected the notion that disadvantaged sections of society should be helped. For the classically conservative elements of the Conservative party, a mutual building society, financially self-contained but assisted by legislation that existed to promote thrift and house purchase for the 'industrious classes', was precisely the kind of institution they would wish to conserve.

Ironically, although at odds with the more traditional elements of its own party, the free market ethos of the New Right was, in the context of building societies, supported by leading elements of the Labour opposition. The latter argued that the privileges building societies enjoyed were assisting managers to operate in a self-serving and financially wasteful fashion. Indeed, an analysis of the Wilson Report, a report headed by former Prime Minister Harold Wilson and commenced in January 1977 under a Labour government, indicates that the language of the market was in greater evidence here than the subsequent Green Paper on the same subject under the chairmanship of Nigel Lawson, Conservative minister of the Thatcher government.

Thus, it is the contention of this thesis that it was the contrary perspectives both between and within the leading political parties that ultimately synthesised into the provisions of the 1986 Building Societies Act. This Act simultaneously bolstered mutuality by loosening some of the constraints on their financial activities whilst facilitating conversion from a mutual society into a corporation dealing in financial products.

It is to the government reports leading up to the passage of the 1986 Building Society Act that this thesis will now turn. The following section examines *The Functioning of Financial Institutions (1980)* or the Wilson Report, *Building Societies: A New Framework (1984)* and the pre-legislative debate in the House of Commons. In so doing it will indicate the different policy perspectives whose relationship led to the 1986 Act.

Parliament, Policy and Mutuality: The Making of the 1986 Building Society Act.

By the early part of the Thatcher administration Labour and Liberal MPs were already putting forward the argument that building societies should be subject to the same market criteria as other financial institutions. The initial response from the Conservative front benches was, at this time, less than sympathetic to this view. Labour and the Liberal MPs complained about the BSA's 'cartel', the tax privileges enjoyed by building societies, the wasteful number of branches and the problem of making directors accountable. In the House of Commons Oral answer session of 22nd May 1980, Nigel Lawson was required to answer on all four issues.[28]

On the first point, the Hon. Mr Budgen stated that the BSA operated as a cartel on interest rates which, he argued, had the effect of reducing the interest of investors and encouraging the growth of the largest societies. Nigel Lawson, far from condemning such non-market practices disagreed that these strategies aided larger societies, on the contrary, he argued that the suppression of competition provided the public mortgage interest rates at 'lower rates than might be expected'.[29] The issues of director accountability in respect of building society lending strategies, raised by the Hon. Mr Grimond and, in respect of the unnecessarily large number of branches, raised by the Hon. Mr Weetch were dismissed by the Chancellor as issues that shouldn't concern government or legislation. The possible problems of managers pursuing their own self-interest

[28] Hansard, oral answer session 22 May 1980
[29] ibid p690

by engaging in mergers, was deemed to be a matter for the Registry of Friendly Societies.

The views expressed by Labour MPs on building societies over the next five years drew upon the conclusions and evidence of the Labour-based Wilson Report.[30] It is to this report, therefore, that this thesis will now turn.

The Wilson Report: Committee to Review the Functioning of Financial Institutions

The first meeting of the committee was held on January 1977, a progress report was published in December 1977 and the completed report was presented to Parliament on June 1980. The Wilson report began by assessing the economic significance of the building society movement. It noted that building societies held a significant proportion of investments, second only to banks. As Table 7 of the Wilson Report shows, total building society assets by the end of 1978 exceeded £39.9 billion[31] and, as Table 8 indicates, this amount was held predominately as loans secured by mortgages.[32]

[30] Committee to Review the Functioning of Financial Institutions. Chairman: Harold Wilson Cmnd 7937 (1980)
[31] Cmnd paper 7937 P41 Table 7
[32] ibid Table 8

Table 7 Deposit- taking institutions: numbers, assets and deposits at end 1978

	Number of institutions	Total Assets (£bn)	Sterling deposit liabilities (£bn)
Banks in the UK	348	219.1	41.6
National Savings Bank:			
Ordinary account & Investment account	1	1.1	1.8
Trustee Savings Banks			
Ordinary department	18		1.7
New department		3.6	3.3
Building Societies	316	39.7	37.0
Finance houses (and other consumer credit granters)(1) (3)	496	2.9	0.5
TOTAL	1,179	266.4	87.1

(1) Figures for finance houses are at end 1976
(2) To non-bank UK residents.
(3) At end 1976 there were 160 finance houses and other consumer credit grantor staking deposits from non-financial sectors: they had total assets of £2.2 billion

Table 8 Pattern of asset holdings of deposit-taking institutions at end 1978

Percentage of total assets

	Banks in UK (sterling assets only)	NSB Investment account	TSB new dept.	Building Societies
Cash and short-term assets	10	7	16	5
Market loans	26	-	-	-
Public sector securities etc.	5	92	74	13
Loans for house purchase	2	-	-	80
Other advances	43	-	3	-
Other assets	13	1	7	2
TOTAL ASSETS in £bn	75.4	1.1	3.6	39.7

The orientation of building societies to this form of investment, with its incumbent 'lend long borrow short' policy meant that they were highly susceptible to the volatile nature of both interest rates and inflation. To counterbalance this, the Wilson Committee reported that building societies relied on two dominant strategies. Firstly, building societies had increased the level of reserves in order to subsidise the granting of lower interest rates to borrowers when interest rates were high and savers were seeking higher returns. Secondly, the Building Societies Association operated a price setting policy for all its members. On the first point, building societies built up reserves through surplus created from the lending and borrowing part of the business (after the deduction of running costs and tax) together with any profits earned from their liquid assets. The reserves were on average 3.5% of the total assets of building societies as a whole. Table 20 of the Wilson Report showed that in 1968 £29million was held as reserves or 3.8% of total building society assets, in 1972 this had risen to £76 million or 3.64% and by 1978 reserves stood at £212 million or 3.73% of the total building society assets. This policy was one that was to have a very significant effect on the success of demutualisation.

These strategies, argued the Report, were not sufficient to immunise building societies from the sharp rises in interest at the end of the 1970s. In 1979 the Building Society Association decided to raise its recommended mortgage rate to 15%. This, coupled with the prudential policy of lending only a percentage of the purchase price had the effect of excluding less wealthy first time buyers. The problem was exacerbated by the societies' policy of reducing this proportion of the purchase price on which they would lend when trying to ration funds.

The Wilson Committee concluded that this policy, 'discriminates against those who find it difficult to raise the necessary deposit'.[33] And, 'because of their tradition of encouraging self-help and thrift, they have frowned upon the concept of "low start" mortgages, believing that those who feel that the initial payments impose too great a burden should defer house purchase

[33] ibid p85 para 289

until such time as they can afford it, rather than be financed for a period by the societies depositors'.[34] And, even more controversially, 'some have argued that it is more sensible for the costs to be loaded in the earlier, rather than the later, years of the loan because in this period it is common for both husband and wife to be employed full-time'.[35]

Instead, proposed the Report, building societies should increase the flow of capital available for loans and offer more attractive rates of interest. This could be achieved by abandoning the policy of protecting weaker societies through the BSA's recommended rates system (set at a rate all societies could afford) and subjecting all societies to a competitive market.

> The only sure way of providing a competitive spur to building societies is in our view to end the recommended rate system, that is, to allow societies to set their own rates according to their circumstances and to break the present automatic link between the rates paid to depositors and those charged to borrowers.[36]
> The dismantling of the recommended rate system would give building societies greater freedom to compete with other deposit taking institutions as well as with themselves.[37]

Equally, the introduction of market criteria could force building societies to abandon their costly policy of opening branches.

> Greater competition between societies would cause them to examine the viability of their branch networks with some care, with the probable effects of promoting mergers-and thus reducing the number of large societies providing facilities nation-wide- or encouraging some degree of regional specialization, perhaps through an exchange of obligations or amalgamations involving smaller, regionally-based societies.[38]

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[34] ibid
[35] ibid
[36] ibid p113 para 380
[37] ibid para 384
[38] ibid p111 para 376

Table: Building society branches, 1968-78[39]

	1968	1969	1970	1971	1972	1974	1977	1978
No. of branches	1,662	1,807	2,016	2,261	2,552	3,099	4,130	4,595
No. of accounts per branch	4,921	5,028	5,092	5,116	5,105	5,029	5,457	5,440
Av. balance per branch(£m)	4.67	4.79	5.03	5.39	5.70	5.98	7.80	8.06
Av. balance per account	949	953	988	1,054	1,117	1,189	1,429	1,481
Av. management expenses per year, per member(£)	4.45	4.75	5.17	5.81	6.31	7.50	11.42	12.65

39 ibid p110 Table 25

The solution was therefore clear and could have been lifted from the Thatcher administration itself,

> External pressure on the cartel results from the queue for mortgages and the expansion of the building societies branch networks, both of which have become matters of grave concern. We believe that these problems could be alleviated by greater competition among the societies.......we recommend that the recommended rate system should be abolished.[40]

Recommendations for the prudential regulation of building societies therefore, derived from the desire to subject societies to the market. Changes in prudential regulation were deemed essential to oversee the changes recommended to increase competition and move away from the situation where, 'the weaker and more inefficient societies have to a large extent been cushioned from normal commercial pressures by the recommended rate system, which limits price competition for deposits, and by excess demand for mortgages'.[41]

The system of prudential control at this time was formally based in statute the provisions of which were overseen by the Chief Registrar of Friendly Societies and informally by the Building Societies Association. The pertinent legislation was the 1962 BSA which, as already noted in chapter 3, proscribes the kind of business a society may undertake, rules of governance and rules pertaining to capital reserves and liquid assets. Before the registrar registers the society-and therefore before it can take deposits, he must be satisfied that it meets the 1962 Act's criteria. After this point however, the registrar's powers were considered by the report to be limited.

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[40] ibid p114
[41] ibid p327

The Wilson Report recommended that the requirements for building society registration and designation should be increased and that the registrar's powers should be extended. They favoured the introduction of minimum liquidity or reserve ratios for those societies seeking designation. In respect of the Registrar's powers they recommended that, 'the Registrar should be given powers to promote mergers or to enforce the winding up of a society for prudential reasons subject to an appropriate right of appeal'.[42]

The collapse of a reasonably prominent society promoted the Wilson Report to recommend a strengthening of accountancy procedures. In 1978 Grays Building Society collapsed losing £7 million of assets. Grays was a medium sized, designated society whose accounts falsely showed assets of £11.5 million. The Registrar's method of monitoring societies was through their annual accounts, however, in this case it fell far short of an adequate method of control. In order to counteract the problem of a society manager falsifying accounts in order to disguise fraudulent activity the committee recommended that there be a substantial increase in the number of visits to building societies made by the registry and that the voluntary cash flow statements should be compulsory. To facilitate this extended supervision, the Wilson Report recommended that a separate organisation should be developed in the registry dealing solely with building society issues. Finally, it recommended a statutory scheme of investor protection so that the protection afforded to depositors of societies who were members of the Building Society Association would be afford to those outside the Association (at that point around 100 small societies accounting for just under 1% of the total of building society assets).

As a generalised approach to reforming building societies, the report recommended that they should operate under the discipline of a competitive market and stricter statutory controls that

[42] ibid p332 para 1250

would further empower the Chief Registrar. This was the report that the Neo-liberal government of Margaret Thatcher inherited, and, in the context of its much vaunted political orientation should have provided an ideal base on which to introduce even more far reaching measures toward *laissez-faire* market strategies.

The Thatcherite Approach: "Building Societies: A New Framework"

At the height of the New Right's free market policy, the government set into motion extensive legislation on building societies. The government Green Paper on the subject, *Building Societies: A New Framework,* was presented to Parliament on July 1984. In the context of the New Right's liberalism this report should have been expected to outstrip the 1980 report in its emphasis on competition and deregulation. Instead, however, in all but one important respect, this paper favoured increased structural control and accountability whilst offering some facility for building societies to offer some additional financial services.

Nigel Lawson's forward to the paper clearly denoted government intention to effect a compromise between free market criteria and the traditional institutional role of building societies. The latter consideration echoing the 1871 Royal Commission's intentions to encourage thrift and home ownership in the 'Industrious Classes' was expressed thus,

> Our purpose is to ensure that the building societies continue primarily in their traditional roles-holding people's savings securely and lending for house purchase- while loosening the legal restraints under which they have operated for a century or more so that they can develop in other fields.[43]

[43] Building Societies: A New Framework July 1984 p2

and later,

> Their primary role as specialising in the housing finance and personal savings markets, and their mutual constitution should remain.[44]

The former consideration was expressed thus,

> So, by allowing the societies new powers, we can both further encourage home ownership and look forward to fuller and freer competition for financial services to the great benefit of all.[45]

and later,

> It is important that building societies should be competitive in attracting savings. Major structural changes are now taking place in the financial services sector.........building societies will probably need to respond to a trend toward 'one stop' centres for financial and investment services.[46]

However, this paper made clear that any change to building societies would be limited and, to the extent that the organisation was liberalised, it would be subject to extra scrutiny. *Laissez- faire* was not to be the policy underlining much of the proposed legislation.

> The scope for diversification should therefore be limited and subject to proper prudential control. Nor should it create significant conflicts of interest.[47]

The 1984 Paper noted that the statutory limits on the activities of building societies and their financial strategies generally had meant that societies had provided a very safe source of

[44] ibid para 1.07
[45] ibid p2
[46] ibid p4 para 1.10
[47] ibid para 1.11

investment for their members. This had allowed building societies to enjoy a certain latitude in their internal organisation. Generally, building societies held 80% of its assets as loans secured on a mortgage, 17-20% in liquid assets and about 1.25% in fixed assets, usually land and offices, whilst its liabilities were drawn almost entirely from the deposits of individual members. This meant that in the absence of fraud from a borrower, or the liquid assets being translated as fixed assets that fell in value, building society's assets were very safe. The Green Paper also noted that, 'societies have been able to afford to keep the interest rates paid to their investors in line with market rates, despite large fluctuations, by lending on terms under which they can vary at short notice the rates they charge their borrowers'.[48]

Thus, contrary to the Thatcherite private enterprise approach, the paper praised mutual organisation for requiring little profitability creating a surplus that allowed for reserves of 0.5% of assets per year. This in turn provided support for the 'borrow short and lend long' strategy which required a high proportion of liquid assets in order to cover fluctuation in cash flow. Indeed, the absence of liberalisation in the building society movement was a positive boon according to this report.

> In general, the very limited range of activities in which the societies can engage on the assets side enables the societies to combine a high degree of security for investors with relatively low reserve ratios.[49]

Furthermore, and in contrast to the staff rationalisation proposed by the Wilson Report, this paper argued that building society's limited orientation meant that,

[48] ibid para 2.03(b)
[49] ibid para 2.04

> Their specialisation also leads to relatively low management costs. Together these mean that they require a relatively narrow margin between the interests rates they pay and those they charge.[50]

Increased activities would bring increased risks, a norm for the 'survival of the fittest' free market so strongly advocated by this government but not in the context of building societies. A strategy, counter- balancing risk would be required. The report therefore recommended that a strong capital base would be required to cover possible losses. And, as societies could only build up reserves through realised profits and, unlike a company, could not rapidly build up capital reserves by a rights issue, a society's reserves, 'should be reasonably matched from the outset to the scale and nature of the risks involved'.[51]

As a gentle nod toward liberalism, the Green Paper proposed that the old Section 1 of the Building Societies Act, which restricted building society activities to 'raising, by the subscriptions of the members, a stock or fund for making advances to members out of the funds of the society upon security by way of mortgage of freehold or leasehold'[52], should be replaced by a new section. This section would now state that, 'the primary purpose of a building society is to raise funds from individual members for lending on security by mortgage of owner- occupied residential property'.[53]

This would allow building societies to engage in related business such as estate agency and Automatic Telling Machines (ATM). Prior to the passage of this Act, building societies had had a problem with certain money transmissions because of a technical point. It could not guarantee

[50] ibid para 2.04
[51] p7 para 2.04
[52] ibid para 2.05
[53] BSA 1962 section (1)

payment, on for example cheque guarantee cards, because it would be agreeing to pay funds to a third party regardless as to whether there were sufficient funds in the account in question. This problem would be overcome by dint of the new powers to offer unsecured loans, a facility that would also enable the use of Automatic Telling Machines.

The Green Paper also proposed that building societies should be empowered to offer an integrated house buying service, 'a package of service to house buyers, including estate agency, conveyancing and structural surveys', subject to any conflict of interests that may arise.[54]

Other services proposed included agency services for building societies' 'under utilised branches' and collecting, 'local authority rent and rates, and bills for public utilities, insurance broking and financial services such as arranging share purchases and general investment advice.[55]

However, the Green Paper consistently emphasised that any liberalisation would be accompanied by enhanced prudential control. Thus, the Green Paper proposed that 90% of assets (other than liquid assets) should be used for residential, first mortgages. Liquid assets should be kept to a maximum of 33.3% and at least 80% of funds should be raised by members. The paper argued that all assets should be classed according to their risks.

Class 1 assets,' advances secured on first mortgage of residential property to individuals who are owner occupiers of that property'[56] would have to represent 90% of commercial assets. This actually narrowed the restriction from previous legislation as its excluded lending to corporate

[54] op cit New Framework para 4.00
[55] ibid para 4.05
[56] ibid para 3.02

bodies or to non- residential property. However, it argued, 99% of lending was made to owner-occupiers and lending to corporate bodies represented a very small proportion of their business.

Class 2 assets 'would consist of other forms of wholly secured lending'[57], such as second mortgages on property whose first mortgage is with another lender, loans secured on non-residential property or loans to corporate bodies or loans made over the value of the property but secured by a local authority indemnity under section 111 of the Housing Act 1980.

Class 3 assets, 'unsecured lending, the ownership of land or property, and equity investment'[58] were very risky investments and, 'would therefore be open only to societies with free reserves of more than £3 million. The widest powers would thus be available at present to 56 societies, whose total assets form over 95% of the movement as a whole'.[59]

Unsecured lending was limited to a maximum £5,000 but introducing class 3 assets did allow societies to own property and act directly as landlords, a power that was originally curtailed because of the Liberator crash noted in chapter 3. Alternatively they would be allowed to engage in land ownership through the medium of a subsidiary.

In respect of engaging in equity investment in subsidiaries and associates, this power was highly circumscribed and entirely distinct from the judicial and statutory approach to the incorporated company. As the paper makes clear,

> the subsidiary route must not be regarded as a way of side-stepping prudential considerations or limitations upon the powers of societies themselves. A financial

[57] ibid para 3.05
[58] ibid para 3.09
[59] ibid

institution of the standing of a building society would take on certain moral obligations towards a subsidiary to which it had lent its good name, over and above that required by limited liability. It couldn't walk away if it got into trouble. Any losses made by the subsidiary- even if the possibility is remote- would potentially be those of the parent building society.[60]

For the incorporated company, a moral obligation to a subsidiary owed by the parent will not give rise to a legal obligation. This is vividly illustrated in the cases relating to corporate contractual guarantees. Here, creditors who hold guarantees from other members of the group may be able to shift the liability around the group by enforcing contractual claims. However, a document that may appear to be a guarantee may fall short of this and may be termed merely *comfort letters* if it not sufficiently specific.

For example in Re Augustus Barnett & Son Ltd, Augustus Barnett had traded at a loss for some years.[61] As a subsidiary of Rumasa SA, its auditors had only been willing to certify their accounts on the basis that Rumusa provided a letter of comfort whereby it agreed to provide the company with financial support. Rumusa allowed these letters to be noted in the accounts. The last of the letters said that they would enable their subsidiary company to, 'trade for at least 12 months at current level and also to provide such long term finance as is necessary'. From 1977-81 Rumusa had provided Augustus with £4,000,000 of subsidy. In March 1983 the board of directors of Augustus Barnett were informed that they were at personal risk of fraudulent trading unless they could obtain funds to pay the company's current debts. The company borrowed money from other subsidiaries and suppliers who were reassured by the statements made by Rumasa.

[60] ibid para 3.20
[61] [1986] BCLC 170

Following a creditor's voluntary winding up in Sept 1983, liquidators commenced proceedings against Rumusa under s.332 Ca 1948 (s.213 IA) alleging that the support and letters given had induced the board to continues trade and incur debts. Rumasa applied to strike out the claim on the grounds that it disclosed no reasonable cause of action.

The court held that the intent to carry on business to defraud creditors must be proven. As there was no allegation that the directors of Augustus Barnett had carried on business in this way there was therefore no basis for asserting that Rumansa was party to defrauding creditors.

Likewise in the more recent case of Kleinwort Benson Ltd v Malaysia Mining Corporation Berhad, the defendant was a PLC in Malaysia who formed a wholly owned subsidiary in England to operate as a ring dealer member of the London Metal Exchange.[62] The plaintiffs were merchant bankers who made a loan to the subsidiary (MMC Metal Ltd) relying on a comfort letter from the defendant which said, 'it is our policy to ensure that the business of the subsidiary is at all times in a position to meet its liabilities to', the plaintiffs. This loan facility was increased from £5 million to £10 million when the defendants supplied a second comfort letter in substantially the same terms.

When the subsidiary went into liquidation the defendant refused to pay sums outstanding under the loan arrangement with the plaintiff contending that the letter had not been intended to impose any binding legal obligation.

On appeal the court held that the defendant's statement in the letter was, 'in terms and context as well as on evidence, a statement of present fact and not a promise as to future conduct: and that

[62] [1986] 1 WLR 379

no promise as to future conduct could be implied: and that accordingly, the terms of the comfort letter had no contractual effect'.[63] There existed a moral responsibility but this couldn't be translated into a legal responsibility. These two cases follow a long line of cases where the courts are almost entirely unwilling to make the parent company liable for the debts of its insolvent subsidiary.

In order to further safeguard the small liberalisation noted above, the 1984 Green Paper, in line with the Wilson Report, stated that the supervisory controls of the Chief Registrar would have to be enhanced, 'if societies are to have greater powers, it follows that his function will need to be extended'.[64]

The report proposed that the system of supervision to be applied should be more like that applied to the banking system although less onerous, as the restraints placed on building society's assets provided a structural control on their activities.[65]

It proposed that any activity outside that proscribed for building societies would be *ultra vires* and could result in the Chief Registrar instructing the society to put plans for conversion to its members. A converted society could then operate under the more liberal rules on *ultra vires* applied to companies. If conversion was not undergone the Chief Registrar could apply to the court for an order to wind up the company or place a number of restrictions upon its activities.

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63 ibid

64 op cit 1984 Green Paper para 2.11

65 Under company law the company has full freedom to construct the multiple objects in the memorandum under Cotman v Broughham (1921), subject to the ancillary nature of powers (Re Introduction). Furthermore, a company can registrar as a general commercial company, section 3A CA 1985, and ultra vires contracts will be enforceable s,35 and s.35A CA 1985)

Furthermore, a building society would now be subject to specific statutory requirements to protect investor's interests.[66]

Historically, the paper argued, the system of supervision by the Chief Registrar had been reactive, as it tended to intervene only in extreme circumstances such as when investor's money seemed to be at risk. Under the 1960 Building Society Act, the powers of the Chief Registrar were encapsulated in section 48 and section 51. Section 48 empowered the Chief Registrar to prevent a society from taking further investments, provided he has obtained the consent of the Treasury. This was an extreme measure as it effectively stopped a society from operating independently and put existing investors at risk in the short term. The registrar therefore had to strike a 'difficult balance'.[67] A Section 51 Order empowered the Chief Registrar to prohibit a society from advertising.

In addition to these measures, two major legislative changes have placed positive control over societies by the registrar. Firstly, the House Purchase and Housing Act 1959 provided for the designation of building societies by the Chief Registrar. Trustees defined in the Trustees Investments Act 1961 could only place funds with a society that had been designated. The Designation Regulations made by the Treasury included, as noted in chapter 3, a minimum percentage of reserves from 2.5%-1%, liquidity of 7.5% and minimum assets of £10 million.

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[66] The Green Paper proscribed para 2.14 as,
"(a) to maintain reserves, and more specifically free reserves, adequate for its particular business;
(b) to maintain liquidity adequate for its particular business;
(c) to observe the limits on building society assets;
(d) to have adequate direction and management for its business and carry out its duties with integrity and prudence;
(e) to maintain adequate systems of internal control and inspection; and
(f) to have adequate arrangements for independent valuation of mortgaged property."
[67] Ibid p 38

Secondly, the Building Societies (Authorisation) Regulations 1981 required that a new society should satisfy the Chief Registrar that they have the necessary resources and management before they can take any investments. These two criteria provided useful controls over new societies but did little to regulate existing ones. According to the report, however, the problem with the Registrar's powers under section 48 was that they were not sufficiently extensive. For example, section 48 of the Building Society Act authorised the Chief Registrar to revoke authorisation provided he has given notice to the management, allowed a period for representations (from the management) and the Treasury has given its consent on the basis that they were satisfied that they could defend the decision to Parliament as being reasonable. The report considered there to be an excessive amount of hurdles and instead, proposed that powers under section 48 would be made discretionary. This would be in line with judicial thinking, which stated in the case of: Regina v Chief Registrar of Friendly Societies that the width of the Registrar's discretion should not be limited to existing categories.[68] The Chief Registrar's enhanced powers would be subject to judicial review and,

> would be struck down by the Court if the Chief Registrar had failed to observe the principles of natural justice, if any of the grounds were wrong in law, and this materially affected his decision, if he could be demonstrated to be wrong on, if he took into account grounds which were not relevant to the interests of investors, or ignored ones that were, or if he appeared to have acted unreasonably.[69]

In general, the main statutory powers of the Chief Registrar would be in relation to granting, withholding and revoking authorisation. In order for a building society to be authorised, the Chief Registrar would have to be satisfied that all the requirements on the board of directors could be complied with and that it would, in general, be capable of safeguarding its investor's

68 ex parte New Cross building Society noted in chapter 3
69 ibid para 30

interests. In order to clarify precisely the criteria by which a director's duty would be judged and that which he must achieve in order to protect investor's interests the paper set out a director's statutory duties.[70]

By prescribing very specific duties the paper hoped to provide an immediate response to a director's failure to meet these obligations. Explicitly, the paper noted that, 'failure of the board of a society to meet one or more of these requirements would be recognised as a ground for the Chief Registrar to exercise one of his discretionary powers'. In addition to this the paper considered raising the minimum capital required from its existing level of £50,000, in order to provide a more secure fund for investors.

Encapsulating the contradictions inherent in the prevailing political climate, the Green Paper presented its anti-thesis to the basic thesis of a restrictive approach to governance. It made a

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[70] ibid p40-41 "(a) to maintain adequate reserves, and more specifically free reserves, for the nature of the business which the society was carrying on, and particularly for its structure of assets and liabilities;
(b) to maintain adequate liquidity in relation to the nature of the business it was carrying on;
(c) to observe the upper limit of 5 per cent on the proportion of total assets represented by Class 3 assets;
(d) to have adequate direction and management for the types of business the society will be undertaking; and to carry on that business with integrity and prudence and with those professional skills which are requisite for the range and scale of the societies activities. To comply with the First Council Credit Institutions Directive the direction of a society will have to be in the hands of individuals of sufficiently good repute and sufficient experience to perform their duties, and who are at least two in number;
(e) to maintain adequate internal systems of financial control and inspection;
(f) to have adequate arrangements for the independent valuation of mortgaged property;
(g) to prepare and publish accounts which must be audited by professionally qualified auditors;
(h) to satisfy the Chief Registrar that the board is carrying out these requirements, and more generally to provide him with such information as he may consider necessary for carrying out his functions under to Act, whether in general or in relation to the affairs of the particular society."

number of proposals deliberately intended to introduce free market criteria. For example, building societies were specifically exempted from Restrictive Trading Practices legislation so that the Building Societies Association's policy of recommending interest rates was not challenged. In response to the abolition of "corset" controls in 1980 which led to banks taking (by 1985) 25% of new mortgage business, the BSA reformulated its interest rate policy. The original policy, noted in chapter 3, that had operated since 1939, consisted of two different agreements described by the Green Paper thus,

> (a) The recommendation of basic rates of interest to be paid on building society investments and charged on mortgages.
> (b) An undertaking by participating societies to give 28 days notice of variations from the recommended rates.[71]

On 21 October 1983, in response to the criticism of the Wilson Report, the BSA announced new arrangements whereby the recommended rates would be replaced by advised rates for ordinary shares and mortgage loans. There would be no requirement to give notice of changes, although there would be an informal agreement under which societies may be notified of each other's rates. These changes, argued the Lawson report, had introduced competition between building societies and it could no longer be 'assumed that the prime objective of building societies should be to keep mortgage rates down'.[72] This meant that, 'the original rationale for exempting the building societies from the legislation'[73] was removed. And, reasoned the report, if this exemption was removed it would allow the Director General of Fair Trading to legally challenge even the 'advisory' function of the BSA on the basis that it was contrary to the public interest. A successful challenge on these grounds would result in building societies setting their own interest

[71] ibid para 6.06
[72] ibid para 6.04
[73] ibid para 6.08

rates without reference to the BSA, entirely subjecting rates to market criteria and in the Green Paper's view, providing, 'a greater range of choice and a better service to building society members'.[74] In order to further this desirable effect, the Green Paper proposed that the exemption from the restrictive trade practices Act should occur simultaneously with the new building societies legislation.

The second arm of the introduction of market criteria had already taken place through other legislation, which homogenised rules relating to taxation of banks and building societies. Tax-paying investors in building societies had previously paid a lower rate because they were paid interest net of a composite rate of tax. This privilege, the report stated, was already now extended to bank investors (from April 1985). In addition, the 1984 budget had already bought corporate tax down to 35% for both banks and building societies, the previous position being corporate tax at 52% for banks and 40% for building societies. The Lawson report approved of this approach.

The third arm of the financial liberalisation of building societies was by far the most controversial as it proposed to allow building societies to change their legal status from that of a mutual society to that of an incorporated company. Originally recommended by the Spalding Report, it was not a proposal that the Green Paper seemed to embrace with much enthusiasm.[75] Indeed, it stated that although a, 'compulsory change to company status has been advocated by some in the past' the government 'does not accept that such a change is needed'.[76] In respect of the increase in competitiveness mooted by the Spalding Report as a reason for enabling conversion, the Green Paper argued that societies had already faced a great deal of competition from other societies and various financial institutions. This competition it argued had resulted in

[74] ibid para 6.09
[75] The Future Constitution and Powers of Building Societies' (1983) Chairman John Spalding
[76] ibid para 5.29

the acceleration of innovative service for customers and restricted the costs of management. However, whilst arguing that conversion was unnecessary, it took the view that,

> It is wrong that a society cannot turn itself into a company if its members wish. The Government therefore intends to provide for this in new legislation. Although there are no signs that many societies will wish to become companies in the near future, this will provide greater flexibility.[77]

If societies chose the conversion route, the resulting business would then be subject to the Companies Act and its directors would owe a fiduciary duty to the company. In addition, the new company would require a license from the Bank of England under the Banking Act. Conversion could only take place following a vote of its members, thus in theory, demutualisation could not take place without considerable, active agreement from its membership. However, as a curious adjunct to proposals on a societies' 'Constitution and Accountability', the Green Paper sought to redefine the qualifications for membership in a way that considerably reduced the number of individuals that would be counted as voters. New governance objectives would ensure orientation toward 'interested members' by removing information and rights that were previously held by 'uninterested members',

> (a) to improve the information available to interested members but to reduce the present burden on societies of circulating to members often unwanted reports and accounts;
> (b) to give groups of members with legitimate concern about how the society is being run a greater opportunity to raise points at an annual general meeting, while at the same time making it harder to abuse the system.
> (c) to tell members more about candidates for election to the board and to make more even handed elections in which candidates other than those put forward by the board are standing.[78]

[77] ibid para 5.30
[78] ibid

In respect of voting on resolutions, the Green Paper then went on to suggest the homogenisation of the rules relating to 'qualification'. The rules at this point stated that all members could table a special resolution, all members with a £1 shareholding could vote and members with £25 were entitled to be sent the annual accounts, the director's report and notice of the next annual general meeting. The commission proposed that it would be, 'more logical to have a single level of shareholding' which gave rights in all the aforementioned areas.[79] This generalised level was proposed to be a £100 shareholding, thus excluding thousands of small investors.

The Bill was presented to Parliament on 4 June 1986 and was passed with little controversy on the majority of points. Conversion, however, caused some debate, lasting one hour and twenty minutes. When it eventually passed with the ayes at 229 and noes at 148, it did so by dint of a large government majority.

Those chiefly opposed to this part of the bill were Labour MPs and more traditional Conservatives. In contrast to Labour's position in the 1970's[80] and those evidenced by parliamentary questions in the early eighties, (particularly those posed by Ken Weetch M.P. for Ipswich), Labour in opposition did not support the free market ethos of the New Right. Instead, it favoured the protection of mutuality, and for the most part, the existing organisation of building societies. Likewise, old conservatism opposed the removal of building societies' traditional role and the removal of the mutual legal status that facilitated this continuity. It is therefore of little surprise that the part of the bill which referred to demutualisation evoked conflicting many views and ambivalence to demutualisation. In the words of Dr. McDonald MP,

> the minister is committed to allowing this process of change to take place while,

79 ibid para 5.11
80 such as the Wilson Committee

on the other, he is uncertain about its usefulness and rightness and is trying to put as many obstacles in its way as possible.[81]

Also reflecting this view was Mr Craigan MP who indicated that many Conservative backbenchers were concerned about facilitating conversion. 'I think the provision[82] has been reintroduced because several back-benchers did not like the idea either. Treasury Ministers felt they had to assuage in some way their back-benchers'.[83]

The minister thus identified above by Dr McDonald was Mr Stewart MP, who opened the debate by characterising the government's approach as a balance between introducing the free market into the building society industry whilst curtailing the debilitating effects of speculation. In his words, conversion must be based upon a 'clear support from investing and borrowing members and from a significant proportion of the entire membership'.[84] Secondly, that conversion should be organised in such a way as to not 'encourage members of the public to switch their funds around in the market on a speculative basis hoping to make a quick profit, which has happened in the United States'.[85] And thirdly that, 'limits should be placed on the compensation payable to outgoing directors so that conversion is not a course of action taken by management in their own interests'.[86]

The decision to legislate on conversion at all, he argued, was based on increased choice, 'the possibility of converting into incorporated status would add to the range of types of society or

[81] op cit debate p936. Hansard.
[82] clause 9(4)
[83] op cit Hansard p941
[84] ibid p935
[85] ibid p936
[86] ibid

mortgage providing institution'.[87]

Dr McDonald argued that the government's justification for including a conversion clause in the Building Society Bill was unfair in that it was based on the 1983 Spalding Report from which the BSA had subsequently distanced itself. The Spalding Report had said that,

> The Association considers that it is necessary to have a procedure by which a building society can convert to another corporate form with the agreement of its members, although it doubts whether many societies will wish to consider this option.[88]

But since these statements the BSA had severely modified its recommendations. Furthermore, argued Dr McDonald, conversion was primarily promoted by Peter Birch, the chief executive of the Abbey National and only subsequently followed by the Halifax because it was, 'possibly feeling that it must follow in the footsteps of the Abbey National'.[89]

Conversion, she went on, was unnecessary from any viewpoint. The BSA had itself stated, that funds raised from member's savings were more than sufficient to provide funds for lending on housing (societies assets stood at £100 billion). Raising finance from public issue was entirely unnecessary. Conversion, she concluded would facilitate take-overs from banks that had no commitment to the provision of finance for housing.

Concurring with this view, Christopher Hawkins MP questioned the wisdom of allowing any commercial organisation to own and control building societies, 'why do we want to allow

[87] ibid
[88] ibid p944
[89] ibid 945

companies which are not building societies to buy building societies, including those that have not converted?'[90] He furthered insinuated that the government was attempting to rig the voting patterns of members in favour of demutualisation by allowing societies to offer cash payments to members following conversions. Such payments, as introduced by the new subsection 4 of clause 19 were characterised by Hawkins as 'bribes' for people to vote for conversion. It was a measure, he argued, that had been 'bounced in by the treasury', and despite his repeated request to discuss the issue, it was not discussed by any government spokesperson.[91]

However, the notion that the government were constructing a piece of legislation that was entirely skewed toward conversion as apparently evidenced above, was not reflected in the degree of member consent required. A high quorum was required for conversion. A vote of at least 20% of members was, as Mr Stewart pointed out, twice the number required to pass a motion on mergers and given the disparate nature of members (who each held one vote) a difficult figure to achieve. It was in the minister's view a hurdle, 'at a level that is not prohibitive but certainly demanding'.[92] On the other hand, he dismissed an uncritical allegiance to mutuality as, a 'sentimentality' that contrasted with the government's pragmatic approach,

> Building Societies can be very large national institutions mutual organisations , or they can be small local or regional societies. Their needs are diverging. If the option of conversion under certain circumstances had not been available, it would have been necessary to draft a bill that went wider as to the business that can be conducted by building societies as mutual societies, in order to take account of the realities of the situation and of the way in which the financial markets are developing.[93]

[90] ibid p950
[91] ibid
[92] ibid p948
[93] ibid

The ensuing legislation evidenced both the desire to make building societies more competitive, by granting them more powers, and the view of the larger societies that the building society movement was not homogenous and, for some, conversion was appropriate. The majority of the Act is concerned with the creation of new powers and freedoms for societies coupled with the extended prudential supervision discussed in the Green Paper. The 'principal purpose' of building societies is stated as the raising of funds to lend on the security of land. Reinforcing this principle, the 1986 Act, in contrast to the 1962 Act determines that 90% of a building society's business must be for this purpose and furthermore that this business must relate to land for residential use.

The Act, however, widened the areas where building societies may borrow. In addition to raising funds from investing members they may also raise moneys from non-retail funds, such as financial markets. However, only 20% of building society liabilities may be raised in this way, with at least 50% of a society's funds being raised in the form of shares.

In general, the Act gave new powers for societies to deal in financial products. In banking, they could provide money transmissions, foreign exchange, overdraft facilities, credit cards, cheque guarantee cards and personal loans. A society could also dispense funds through automatic telling machines. In the area of investment, societies could act as broking agents, and provide personal equity plans and insurance services. As an adjunct to their primary purpose, societies could now offer a range of services relating to property. These included powers to operate estate agents, offer conveyancing and property valuation services and to directly develop land and housing.

The above liberties were limited, in that no unsecured loan could be above £10,000, ownership of insurance companies was limited to 15%, land development could be only be for residential uses, societies could not trade in equities and no business could be conducted with non- EC countries. In other words, the role of building societies as financial institutions for the industrious classes engaged in savings and house purchase was underlined, whilst the increased expectations of its members in respect of financial products such as debit and credit cards, overdrafts and 'one stop shopping' was realized.

In themselves these measures were a sensible and pragmatic response to modern financial demands and could have enhanced the building society movement whilst it continued to operate under mutual status. However, these extensive provisions would be overshadowed by a handful of sections whose aim was to achieve the opposite result, not to maintain mutuality but to transfer the business of a mutual society to a commercial company.

These sections operate in this way. Sections 97-103 in conjunction with schedules 2 and 17 of the 1986 Act provides for the power of members to convert to plc status from mutual status. Section 97 (1) states that, 'A building society in accordance with this section and other applicable provisions of this Act, may transfer the whole of its business to a company'.[94]

As a constraint on conversion and, as outlined by Mr Stewart in debate, the Act provides that there must be an investors' special resolution and a borrowing members' resolution. In order to convert, 20% of investing members entitled to vote must vote and, of that, 75% of investors and 50% of borrowers entitled to vote must vote in favour of conversion. When the transfer is to an existing company, as opposed to one specially created for the purpose, then the percentage is 50% of those eligible to vote on the special resolution, or the holders of 90% of share capital

[94] 1986 Building Society Act section 97

must vote in favour.

Under section 100 'the terms of a transfer of business by a building society to a company which is to be its successor may include provision for part of the funds of the society or its successor to be distributed among, or other rights in relation to shares in the successor conferred on, members of the society, in consideration of the transfer'. This payment, however, would only be made to 'those members who held shares in the society throughout the period of two years which expired with the qualifying day'.[95] Characterised earlier as 'bribes', these payments would only be paid to those members qualified to vote on a motion on conversion.

Following a vote in favour of conversion, application is made to the Commission for confirmation of transfer that will be given unless any of the criteria in subsection three of section 98 applies. These provisions include when the Commission considers that,

> (a) some information material to the members vote was not available to all the members eligible to vote; or (b) the vote on any resolution approving the transfer does not represent the views of the members eligible to vote; or (c) there is a substantial risk that the successor will not become or, as the case may be, remain (an authorised institution for the purposes of the Banking Act 1987); or (d) some relevant requirement of this Act or the rules of the society was not complied with.

However all the above may be disregarded by the Commission if it feels that they were not material factors in the members decision.[96]

Following confirmation, the stock is floated, with a percentage of free shares being given to members entitled to vote for conversion. All property, rights and liabilities of the building

[95] 1986 Building Society Act section 100
[96] 1986 Building Society Act section 98(4)

society pass onto the successor company on the vesting date specified in the transfer agreement.

In specially formed companies, no one person will be allowed to hold more than 15% of the issued share capital or debentures for a period of five years, although the Bank of England held a discretionary right to waive this requirement. The Bank of England played this role as the regulatory supervisor of a public limited company dealing in financial products like the converted or demutualised building societies and will consider an application for a licence under the Banking Act 1979.[97] The newly converted society will also be subject to the Companies Act 1985 and will no longer operate under the Building Societies Acts.

Conclusion

As the above evidence suggests, the 1986 Act emerged as a manifestation of the contradictory political elements in the 1970s and 1980s. It facilitated greater opportunities for building societies to offer financial products and increased prudential control to counterbalance these liberties, but is known primarily for its provisions on conversion. Most building societies decided to avail themselves of these provisions and now engage in business under the non-mutual corporate form.

However, as these demutualised societies operated on a 'one member one vote' basis, it is submitted that notwithstanding the free market facility encompassed in the 1986 Act, conversion

[97] The regulatory role for both converted and mutual societies is now played by the Financial Services Association .

would not have been possible without the active consent of a substantial proportion of a society's membership. Members would decide whether they wished to retain mutuality or whether to shed this status and so member's appreciation of and views on mutual status were therefore crucial in deciding how effective section 99 would be. With this in mind, the following chapter examines empirical evidence on members' views on mutuality and their attitudes to conversion. It will examine evidence that suggests there has been a shift in attitudes to mutuality and assess whether this shift would affect voting habits.

It will also assess the role of the building society director in directing and instigating conversion through analysis of interviews with existing building society chief executives. The factual evidence on actual conversions will then be assessed in chapter 6

Chapter 5

Demutualisation: The Facts

1. Introduction

2. Mutuality in Doubt

3. Testing the Water: The Demutualisation of the Abbey National Building Society

4. Managing Demutualisation: The Directors' Role in Conversion

5. Demutualisation Continues:

The Cheltenham & Gloucester Building Society

The National & Provincial

The Halifax Building Society

The Alliance & Leicester and the Woolwich Building Society

The Bristol & West Building Society

Northern Rock Building Society

6. Conclusion

Introduction

> The Government has created a new competitive world in financial institutions. I am glad to see it, because it could have done with more competition, goodness knows.[1]

In the context of the market- based understanding of socio-political relations in the eighties and nineties and the facilitating aspects of the 1986 Building Society Act, mutuality was understood as either a hindrance or an opportunity and, above all, as something that could be dispensed with. The inhibitive nature of mutuality, largely a policy construct, had been progressing for many decades and the concerns many societies felt as a result of this were exacerbated by the increasing competition from banks offering mortgage facilities.[2] Most vociferous in demanding greater freedoms for mutual societies were the larger societies, in particular the Abbey National Building Society, which was among the largest of financial institutions in the UK.

The 1986 Building Society Act provided for the ultimate freedom desired by the Abbey, the ability to shed mutual status and convert into a public limited company. And, although the opportunity for members to gain financial reward through the process of demutualisation was anticipated prior to the passage of the Act, as commentators had already seen the speculative nature of demutualisations in the US, it was the demutualisation of the Abbey National that first

[1] Mr Weetch Labour MP for Ipswich Hansard 1985 Debate on Building Societies Bill p984
[2] Discussed in previous chapter

showed how this process could bring financial benefits to building society members in the UK. The possibility of financial reward encouraged 'entrepreneurial' individuals to become members of societies with the sole aim of putting forward a motion to convert. A successful motion would ultimately award them personal compensation following the sale of the society to a company. These individuals, outwardly despised by the building society industry, became known in the late 1990s as 'carpet-baggers', the most famous of these being the one-time butler Michael Harden.

As a result of these factors, the 1990s was a decade when over 80% of building society assets were transferred to public limited companies. Those societies who wished to remain mutual were therefore confronted with task of convincing their members that remaining a mutual was preferable to conversion with its attendant one-off financial reward and, for the most part, this meant clearly articulating the nature, meaning and benefits of mutuality. The success of this particular strategy is examined in the following two chapters. The purpose of this chapter is to provide an account of the demutualisations facilitated by the 1986 Act and to assess the factors that led to this.

CONVERSIONS

Bradford & Bingley BS to Bradford & Bingley PLC 4 December 2000

Northern Rock to Northern Rock PLC 1 October 1997

Woolwich BS to Woolwich PLC 7 July 1997

Halifax BS to Halifax PLC 2 June 1997

Alliance & Leicester BS to Alliance & Leicester PLC 21 April 1997

Abbey National BS to Abbey National PLC 12 July 1989

Transfer of Business to PLC

Birmingham Midshires BS to Halifax PLC 18 April 1999

Bristol & West BS to Bank of Ireland PLC 28 July 1997

National & Provincial BS to Abbey National PLC 5 August 1996

Cheltenham & Gloucester BS to Lloyds Bank PLC 1 August 1995

Mutuality in Doubt:

Despite the government's assertion that it would be unlikely that building societies would avail themselves of the facility to demutualise, societies began to explore the possibilities almost immediately after the publication of Statutory Instrument, *The Building Societies (Transfer of Business) Regulations 1988 (No.1153).* In January 1988, the Halifax Building Society appointed the merchant banker NM Rothschild to study the possibility of converting into a public company.

In the words of *a Financial Times* survey, 'the Halifax is adamant that at this stage, it is only reviewing options, and that conversion is only one of them. Nonetheless there is a strong inference that the days of mutual status, at least as it has been known until now, are numbered'.[3]

In respect to the large proportion of members required to approve demutualisation, the survey argued that although this used to be considered an 'insuperable hurdle', 'most now seem to believe that they probably will be able to do it, even if voters have to be given some sort of sweetener to approve the change'.[4] It argued that the main obstacles to demutualisation was the fear that the market may become swamped by building society shares or that mergers would have to be completed before conversion, as legislation protected the new entity in its entirety for the first five years of existence. Any general hesitation by societies were based purely on the attempt to learn about possible pitfalls from converting societies, and not a heartfelt desire to preserve the traditions of mutuality; 'second tier societies that say that they see no immediate need to shed mutuality are assumed by others to be biding their time, perhaps in the expectation that, once the first wave of conversion is over, building society flotations will be quite normal'.[5]

A similar report was commissioned by the Woolwich Building Society from Prima Europe, a policy research group based in London, which was published on 15 November 1988. This report concluded that although building societies were under increasing pressure from banks, even without the defensive armoury of being able to raise capital through the sale of equities or the ability to trade in diverse financial products, mutuality could still remain a feasible option. It argued that, 'the healthy rate of capital generation by societies appears sufficient to pursue a successful development strategy which opens up new prospects of income to counter any

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[3] David Barchard Mar 1988 Survey of Building Societies: FT
[4] ibid
[5] ibid

squeeze on mortgage margins'.[6] The predominant view among building societies was that wide-scale mergers would help preserve mutuality. Reflecting this view, the chief executive of the Woolwich Building Society was reported as arguing that, 'the remaining societies would evolve into mutually owned retail banks competing with the main banks but insulating customers from risks such as developing- country debt'.[7] However, as the article cynically remarked, any new found allegiance to mutuality was probably driven by the desire for managers to retain their status by avoiding the consequences of take-over to which societies would be vulnerable in the event of conversion.

The Leeds Permanent Building Society commissioned a similar study from Habros but decided against conversion, subject to review, in 1990. In addition, the National & Provincial appointed JP Morgan, the US Bank, to advise it in February 1989, although a previous poll had already suggested that its members were in favour of conversion.

As a general assessment on mutual societies, Morgan Grenfell, the London Merchant Bank, published a report arguing that, 'the best long-term future of many big building societies may lie in shedding mutual status and joining a financial services group offering a wide range of products to its clients....many of the top 20 societies will find it increasingly difficult to survive alone in increasingly competitive financial services market in the next decade.'[8]

In short, at this point in time, the general view of the larger societies and that of their advisors

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[6] quoted in 'Mutual Dilemma for Building Societies: The pressures to seek banking status by flotation: FT 16 Nov 1988

[7] ibid

[8] 3 April 1989 Building Societies 'May Have to Alter Status to Survive' FT David Barchard report published on 3 April 1989

was that mutual status was just one method of organising business among many, and that any decision to shed mutual status, or retain it, would be based on pragmatism. It was to these larger societies that the industry in general looked to be advocates and protectors of mutuality. Ironically, it was these societies that displayed very little regard for the social and moral aspects of mutual status that were trumpeted by the industry in the latter part of the 1990s. The notion of mutuality had not yet become the stuff of a moral crusade or yet crystallised as a potent enemy of social exclusion. Indeed, it was not until its most powerful protectors 'changed sides' and succumbed to conversion that it became so.

Testing the Water: The Demutualisation of the Abbey National Building Society

The commissioning of the aforementioned reports was, in part, prompted by the announcement from the management of the Abbey National that they intended to demutualise the society. The chief executive of the Abbey National, Peter Birch, become a vociferous spokesperson for the demutualisation of the Abbey and, indeed, societies in general. To the *Financial Times* he said,

> Critics have warned of the danger of becoming a PLC. They overlook the danger of remaining mutual, which could involve becoming victims of squeezed margins and eventual decline. The temptation to equate mutuality with motherhood and PLC status with rapaciousness, is simplistic and wrong and insulting to both mutual and public limited companies'.[9]

Shedding mutual status, argued the same article, was merely another example of the tendency towards innovation that was intrinsic to the Abbey National tradition. In support of this

[9] Peter Birch quoted in FT 11 Feb 1989 Survey of Building Societies: In the PLC limelight- Abbey National by Jemima Kallas

proposition it cited the Abbey National's initiative to build houses (in 1981 with Tower Hamlets LBC), its launch of the first £100 cheque guarantee card, its payment of interest on current accounts, its entry into the Spanish property market and the fact it was first to allow buyers to see the society's valuation report. Conversion was just another 'outstanding Abbey first'.[10] However, innovations as a building society could hardly be compared with a decision to cease to be a building society, indeed, many Abbey members believed that demutualisation would mark the end of good service for members and the end of the Abbey as a socially responsible institution.

These arguments ran contrary to the management's view and, as soon as was legislatively possible, they began a process that ended with the first building society conversion. In September 1988 the company, Abbey National Plc, was registered under the directorship of Barry Ellis, Norman Wilkes and Ian Kinsman Treacy. As a wholly owned subsidiary of Abbey National Building Society, it was created with the express purpose of facilitating the conversion of the building society into a public limited company. Specifically clause A(1) of its objects stated that the company has been established,

> to enter into a transfer agreement pursuant to section 97 of the Building Societies Act 1986 (the BSA) with Abbey National Building Society (the "society) and , pursuant thereto, to assume and conduct, after the vesting day thereunder, as the same is defined in the BSA, the business of the society upon vesting of the property, rights, liabilities and obligations thereof in the company pursuant to the said transfer agreement and the BSA, to carry on such business.[11]

Later, and in compliance with Section 288 of the Companies Act, Notice of change of directors was delivered for registration at Company House on the 18th February 1988, the original directors were to be replaced by thirteen new directors including Peter Birch and Peter Davis. In

[10] ibid
[11] memorandum of Abbey National plc Companies House

March 1988, the management announced its plan to shed mutual status and a transfer agreement was drafted and put forward to the Abbey's membership for approval.

In the event, and with far reaching results, the transfer agreement drawn up by the Abbey's management, was questioned by the Building Societies Commission on a number of points. This led to a resolution in court that served to smooth the path to conversion and encourage the practice of 'carpet-bagging'. In attempting to concretise some of the legislation that the commission assumed existed to preserve the integrity of mutuality, it confronted a judiciary who interpreted the legislation in a more liberal and effectively pro-conversion manner.

The proposals in the transfer agreement that were problematic, related to Section 100 of the 1986 Act. The first related to the kind of arrangement to which section 100(8) related; the second as to whether or not the offer of shares to members who were not two year members was contrary to Section 100, which provided for the giving of the right to subscribe for additional shares, 'in priority to other subscribers', to two year members only; while the third question related to the issue of which members were entitled to cash distributions.

On the issue of who qualified for cash distributions, the court held that members who were investors or borrowers 'on the qualifying day and qualified to vote on the requisite shareholder's resolution and each borrowing member entitled to vote on the borrowing member's resolution'.[12] would be entitled, free of charge, to an allocation of fully paid up shares in the successor company'.[13] Thus, membership, for the purpose of qualifying for a cash distribution, was defined by the court in accordance with section 100(4), as somebody who was a member on the

[12] Abbey National Building Society v Building Societies Commission (1989) 5 BCC 259 at 261

[13] ibid

qualifying day and who remained a member continuously until the vesting day.

In respect to the second point, the Commission submitted that the offer of additional shares should be limited to two year members only and to offer such shares to other members was unlawful under s.100(8). The transfer proposal, it argued, was contrary to the provision of that section in that, 'the member's rights to free shares are to be granted in priority to the rights to subscribe for the new shares conferred on *other subscribers*'.[14]

The court held that section 100(8) did cover those situations where there is a subscription for shares in the successor company and '(1) there is a subscription for shares in the successor company, and (2) the subscriber is bound by an obligation imposed by the transfer agreement itself to vest the shares so subscribed for free of charge in the members' and that 'such right is enforceable by each member under sec. 97(5)'.[15] However, it maintained that the mischief that the section was designed to counter was the attainment by members (other than two year members), of priority rights in respect of a shares issue. Thus the section would be infringed if, 'members other than two year members, are by the transfer agreement given the right to acquire any shares in the successor company, and such right is given to the exclusion of or in priority to persons who are given by the transfer agreement rights to subscribe for those or any other shares in the successor company'.[16] There was no such contravention, the court concluded, if, the same class of members is entitled to free shares and to subscribe to the new shares, as no priority right is conferred.

The overall outcome of this decision was that short- term membership was no bar to gaining the

[14] ibid p264
[15] ibid for both quotations
[16] ibid p265

same personal benefits afforded to long-term membership unless long-term members were themselves excluded from these benefits. There was now an open door for potential carpet-baggers.

Conversion was approved by members on 11th April 1989 and confirmed by the Building Societies Commission on 6th July 1989. Given the proportion of members' votes in favour, it seems to have little choice but to confirm. As the *Financial Times* argued, 'The commission seems to have decided at the outset that the size of the pro-flotation vote - around 90 per cent of members on a 60 per cent turnout - meant the conversion had to go ahead'.[17] Thus, upon the admission of the share capital onto the Official list of the Stock exchange and upon authorisation from the Bank of England, conversion was complete and trading of shares in Abbey National plc began.

Managing Demutualisation: The Director's Role in Conversion.

Demutualisation could not have taken place without the consent of the members and, as previously noted, the Building Societies Commission would have probably refused confirmation if the vote had not been so overwhelmingly in favour of conversion. However, in the case of the Abbey National, there is evidence to suggest that the conversion process was designed and driven by the management to such an extent that members were unable to make an objective judgment. In other words, the retention of mutuality as something that was still beneficial for members, was a view that either ignored or in some people's view, suppressed.

[17] 7 Jun 1989 Abbey National Flotation Survives Tide Of Criticism: A regulator's report into the building society's conversion procedures: FT David Barchard

The benefits for members of the demutualised building society were formally expressed thus,

> every qualifying saver, every qualifying borrower and every qualifying employee who makes a valid application for shares will be subject to the terms and conditions set out in Part XIV, receive at least 100 shares, whatever the demand for shares.[18]

And, secondly,

> every qualifying member and qualifying employee will receive 100 free shares and any member who is eligible as both a saver and borrower will receive 200 shares.[19]

However, a number of Abbey National members, in their campaign to stop the demutalisation of the Abbey, argued that these benefits had been distorted and the management was engaged in an attempt to misrepresent the consequences of conversion. Organised as the Abbey National Members Against Flotation (AMAF), a number of pro-mutuality members claimed that the Abbey's directors had undermined their members' volition and control over the procedure for demutualisation by giving one-sided information on its effects and benefits and by suppressing alternative interpretations. They argued that the management had failed to heed the words of the Building Societies Commission when it warned the society that it had the power to cancel conversion procedures if it found partiality in the ballot. In the words of Michael Bridgeman,

> It is important that the board explains to the membership the potential consequences of conversion, favourable or unfavourable, as objectively as possible....it is not a marketing exercise.[20]

[18] Part 1 Key Information, registered at Companies House 14/7/89
[19] ibid
[20] Speech at BSA conference 1988 quoted in R.W.Perks "The Fight to Stay Mutual"

AMAF argued that the directors were unable to be sufficiently objective as they were all in favour of conversion. To counter this bias AMAF suggested that they (AMAF) should bring the case to members. In pursuance of this AMAF sought to requisition a Special General Meeting. They obtained the signatures of 110 qualified members and provided the cheque of £5,000 necessary to accord with Rule 32(3) of the society's rules. The requisition stated that the purpose of the meeting was to discuss certain resolutions relating to the impartiality of the board and information on demutualisation. In addition to this the requisition stated that

> ...that this meeting *instructs* the Directors to provide facilities to AMAF to enable it to inform all members of the society of the reasons why the Society should remain a mutual building society existing for the benefit of its members.[21]

The requisition was rejected as a result of this wording. On a technical point relating to the above resolution and, in particular, the italicised word, they argued that to convene a meeting to discuss a resolution to 'instruct the director', would be contrary to the Rules of the society which,

> confer on the board the power to direct and manage the business of the Society and the right to exercise all powers of the society which are not, by statute or by the Society's Rules, required to be exercised in general meeting.[22]

In short, members could not instruct directors under the Rules of the Society. It is indeed arguable that, although acting within the properly advised letter of the Rules, there was little attempt to honour the spirit of a director's duty to its members.

This approach continued in the directors' subsequent actions. R.W.Perks, member of AMAF, reported that following the failure to convene a Special General Meeting, the AMAF nominated

[21] ibid
[22] ibid

seven candidates for election on the board in order that they might present the views against demutualisation at the Annual General Meeting.[23] This might have been effective action, for, as the Financial Times noted, 'putting up candidates will mean that AMAF can circulate its views to all Abbey's members in the election statement, something it has been unable to do so far'.[24] However, Perks argued that in direct response to the nominations, the directors took the unusual step of postponing the AGM to the latest, legally permissible date, 26th April 1989. At the same time they set the date for the SGM, the meeting in which flotation was to voted upon, for the 11th of April, two weeks before the AGM. In addition to the timing of the meeting, the AGM notices that contained the pro-mutual views of the AMAF candidates were not sent out until the latest legally permissible date, in this case the 1st April. In contrast, the floatation vote papers were sent out from the middle of March 1989, with instructions to vote, 'immediately'.[25] It is therefore likely, as Perks suggests, that, 'most of those intending to vote would have done so before receiving the AGM papers'.[26]

Although the AMAF failed to halt the vote on demutualisation in the case of the Abbey National, their actions highlighted the problems of protecting mutuality generally. They showed that a partial management could, within its given powers, control discussions and access to information on a proposed conversion. Secondly, they showed that the body empowered to oversee conversions, the Building Societies Commission, effectively disempowered itself by a tautology. The 1986 Act conferred on the Commission the power to refuse to confirm a transfer if a society failed to properly inform its membership.

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[23] ibid
[24] David Barchard "Finance and the Family: A Change Of Habits at the Abbey" Financial Times p6, 17 Dec 1988
[25] op cit Parks p415
[26] ibid

Schedule 17 of the 1986 Act imposed, 'an obligation to issue statements (or summaries) to its members relation to the proposed transfer'.[27] And, under section 98(3), the commission could refuse to confirm a transfer if it,

> considers that-
> (a) some information material to the members' decision about the transfer was not made available to all the members eligible to vote; or
> (b) the vote on any resolution approving the transfer does not represent the views of the members eligible to vote; or
> (c) there is a substantial risk that the successor will not become or, as the case may be, remain (an authorised institution for the purposes of the Banking Act 1987); or
> (d) some relevant requirement of this Act or the rules of the society was not fulfilled.[28]

On considering this criteria in respect of the Abbey's flotation application, the Commission reported among other criticisms that the Abbey had failed to keep its members properly informed. The Commission argued that, 'Members could reasonably have expected to find the fair and balanced assessment of the consequences of the proposal.....It did not measure up to that standard'.[29] The same article described the commission's report on the Abbey conversion as 'stinging' in its criticism of the bias and dissembling of Abbey's Board.

However, the Commission did not conclude that the misleading nature of the information given to members was instrumental in their voting choice. Paradoxically, the Commission allowed the conversion to go ahead because of enormity of the vote, although the vote itself was, according to the commission itself, based on misleading information. As the Financial Times commented,

[27] s.98 Transfers of business: supplementary provisions (1)
[28] The Building Societies Act 1986
[29] Reported in the FT 7th June 1989 "Abbey National Survives Tide Of Criticism: A regulator's report into the building society's conversion procedures: p11

this decision seemed even more contrary given that the Commissioner himself had, 'warned specifically that he would not grant permission for conversion if it emerged that members had not been fully informed of the disadvantages as well as the advantages'.[30]

This decision came as no surprise to financial commentators. Two months prior to the confirmation the Financial Times commented that, 'it would be a revolutionary move, however, for the commission to overrule the results of such a large ballot, and most city analysts believe that is unlikely'.[31]

The particular reasons for the Abbey's conversion may have been self- interest. Representatives from the AMAF were inconclusive as to the motivation of the directors in pursuing demutualisation but suggest that this may have been a factor.

> The motivations of the professional managers may have included their own remuneration. The total remuneration of Abbey National directors increased from £0.4 million in 1986 to £0.7 million in 1988, prior to flotation; post flotation it increased to £1.2 million, and employee share schemes were introduced.[32]

However, what was clear by the end of 1989, was that a motivated board of directors could persuade a sufficient number of members to vote in favour of demutualisation, and were easily a match for a Commission with a limited stomach for court action and a judiciary committed to commercialism. The factors were in place for a building society that wished to demutualise, to do so and with greater ease than had been apparently envisaged when the 1986 Act was drafted.

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[30] ibid

[31] 13 April 1989 Building Societies May Follow Abbey's Lead: The Implications of Tuesdays vote for stock market Flotation: FT p 25 David Barchard

[32] op cit Perks p425

Abbey National: Mergers in alphabetical order.
Abbey Road BS
Borough BS
Bradford Third Equitable Benefit Building Society
Burnley BS
Definite Permanent BS
Devon & Cornwall BS
Ebor Permanent Investment BS
Elgin Property Investment BS
Haslemere BS
Haslemere & District Mutual BS
Highgate BS
Keighley & Craven BS
Leeds Provincial BS
National BS
National & Provincial BS
Oak Co-operative
Provincial BS
State (The) BS
Swansea Thrift Permanent BS
Uxbridge Permanent BS
Western Suburban Permanent BS
Westmorland Permanent Benefit BS
White haven & West Cumberland BS

(Tables correlated from information on the BSA Website)

Demutualisation Continues:The Cheltenham and Gloucester Building Society

The extent to which the judiciary interpreted the law on conversion was, to a certain extent, tested in the demutualisation of the Cheltenham and Gloucester Building Society. In this case, the legal limits on the kinds of benefits that members could receive upon demutualisation were laid down, which would make the process of carpet-bagging slightly less attractive.

The C&G began life as the Cheltenham & Gloucester Benefit and Building Investment Association in 1850. Following the passage of the 1874 BSA it incorporated as the Cheltenham and Gloucester Permanent Mutual Benefit Building Society in 1878. Following a number of mergers the Cheltenham and Gloucester Building Society (as it was renamed in 1908) had by 1995, 230 branches and £17bn in assets. It had 825,000 shareholding members who were entitled to vote and 370,000 borrowing members, entitled to vote and 61,000 depositors. In 1993, it had a pre-tax profit of £202m and a general reserve of £864 m

The reasons for demutualisation given by the Cheltenham & Gloucester, as expressed by its management, were the limitations of the 1986 Building Societies Act. The C&G were a highly successful society, reporting a 27 % increase in pre-tax profits, from £144.7m to £183.8m, for 1991, the fifth year in succession that the C&G's profits had grown by more than 25%. However, this success gave rise to complaint from its chief executive, Mr Longhurst, who stated that, ' the performance showed resilience in a very difficult market'.[33] He went on to warn the government that unless it changed, 'the legal limits on the amount of the funding which building societies can raise on the wholesale money markets'[34] he would consider conversion as the way forward for

[33] FT 14 Feb 1992 UK Company News: Cheltenham & Gloucester advances by 27% to pounds 184m David Barchard
[34] ibid

the society. The limit on wholesale funding was supported by the Building Society Commission, which argued that to make a shift from raising funds from members to other sources would mean that societies would cease to operate as mutuals, (the ceiling for raising money from other sources was set at 40%). However, this was not a compelling issue for Mr Longhurst who concluded, 'we do not subscribe to the view that mutuality is the only way forward for our industry'.[35]

The Cheltenham and Gloucester ultimately evaded the aforementioned limitations of mutuality by merging with Lloyds Bank. The C&G was sold to Lloyds for £1.8billion with the argument that, 'only by becoming part of a larger group could it gain distribution without endangering its enviable low cost income ratio'.[36]

Significantly, the terms of the initial merger deal provided for a cash payment to all members regardless as to whether they were 'two year members' or not. The legality of these terms was tested in court in 1994 and those in the building society industry were alert to the importance of the decision. In a report on the Building Societies Association Conference of 1994, prior to the decision, the Financial Times noted that, 'the tales in the hall during the Building Societies Association conference were about the housing market, the savings market, technology and regulation. The talk in the bars and receptions, by contrast, was of next week's court case in which the legality of the Lloyds £1.8 cash bid for the Cheltenham and Gloucester building society will be tested'.[37] Conference speeches were underpinned by 'vigorous defenses of mutuality' and concern was widely expressed that speculative demutualisations would be the

[35] ibid
[36] FT Alison Smith 11 Nov 1995 Weekend Money: Are mutuals friendless?
[37] FT C&G case dominates behind-the-scenes talk: The Lloyds bid has focused the attention of BSA delegates. 20 May 1994

outcome of a decision that gave cash offers to members who were not 'two-year members'. The article reported that Mr Geoffrey Lister, BSA chairman and chief executive of Bradford and Bingley, told a press conference that, 'if the deal was allowed to go ahead, then the BSA would immediately press the government for a change in the law, in time to affect any future cash bids'.[38]

The program for merging began thus. The directors of C&G supported Lloyds Bank's take-over offer of £1.8 billion on the basis that,

> freed from the borrowing restrictions affecting building societies and with access to the bank's treasury, the business will be able to borrow more heavily......Lloyds Bank will make further capital available, and the business can take advantage of the bank's distribution strengths.[39]

However, the Commission in their capacity as regulator of building societies argued that the proposed terms of the take-over were unlawful. The court itself acknowledged the importance of the case, in the words of Sir Donald Nicholls V-C

> The disagreement raises questions of fundamental importance about the meaning of the statutory provisions. This is virgin territory, because no building society has yet transferred its business to an already existing institution. To resolve this difference of opinion without delay, C&G has bought these proceedings against the commission seeking a declaration.[40]

The plaintiff argued that it was within its powers under s97 (1) of the BSA 1986 to transfer its business to C&R a wholly owned company of a holding company owned by Lloyds Bank and

[38] ibid
[39] Cheltenham and Gloucester Building Society v Building Society Commission (1994) ChD 65 at p66
[40] ibid p67

that the successor company could make cash payments of £500 to each investing and borrowing member and to each employee of the plaintiff. It further contended that these payments were not prohibited by section 100(9) of the 1986 Act which 'prevented an existing company from offering cash bonuses to voting members who held their shares for less than two years'.[41]

It further contended that the Commission did not have general powers of discretion in relation to a transfer agreement approved by the statutory required percentage of members, its role was merely to ensure compliance with statutory requirements. As such, the Commission must confirm the transfer to a successor company, one specifically formed for the purpose of carrying on the society's business. Alternatively, if the society's business was being transferred to an already existing company then this transfer is a take- over but in both cases the Commission must be satisfied that the company will remain an authorised institution for the purposes of the 1987 Banking Act.

The court outlined the possible 'mischief that may arise from these procedures', as being the provision of, 'a means whereby an outside institution might takeover a building society business by tempting members with the offer of a substantial cash bonus'.[42] Similar provisions had already resulted in a spate of speculative demutualisations in the United States' mutual sector.

In order to inhibit such speculation the court noted the statutory provision for a high percentage of members that were obliged to vote in favour of conversion. In addition to this, it argued that section 100(9) provided a restriction on the permissive section 100(1). The latter proscribed no statutory authorisation for the making of payments to members in consideration of the transfer

[41] ibid
[42] ibid p69

outside the rules of the society in question. However, section 100(9) operated as a regulatory measure by restricting to whom the distributions could be made. Thus, payments to newly joined members who may have joined the society purely to benefit from payments arising from demutualisation, were restricted. In other words, the court argued, the provision was designed to prevent carpet- bagging.

> Section 100(9) is plainly directed at restricting the cash payments a successor company may make to members in consideration of the transfer. The legislation seeks to achieve that result by making the s 100(1) power subject to the s 100(9) restriction. Whatever a successor's own constitution may provide, the terms of a transfer agreement cannot include a term under which the successor will make a cash distribution to newly joined members.[43]

Such a restriction was clearly intended, the court maintained, to apply to other companies in the group not just to the successor company. In this case, a proposal that the parent company should make payments to members was derived from, ' the perceived need to side-step section 100(9) and offer cash bonuses to all the members, not just the two year members'.[44] In terms of the preservation of mutuality, this was the most important decision of the case, as potential 'carpet-baggers' would not receive cash payments unless their membership had been of some duration.

Other aspects of the case were dealt with in the following way. In respect of the payments to employees who were non- members, the court maintained that, notwithstanding the consent of the members, the power to distribute to non- members was not held in section 100(1) as this referred to distributions to members only. However, in this particular case, payment was being made by another company therefore powers under the Building Society Act 1986 was not required. The only question that remained was whether or not the transfer agreement could

43 ibid p70
44 ibid

contain a term that allowed a third party to make a payment to non- members. The court stated that it, 'could see nothing in the legislation to indicate that a third party may not join in a transfer agreement made between a society and its successor'.[45]

On the issue of the director's power to enter into such a transaction on behalf of the society, the court concluded that, notwithstanding rule 30.2 of the society, the validity of the transfer was dependent on a members' resolution to that effect. Rule 30.2 provided that,

> No director shall vote as a director in regard to any contract, or proposal therefore, in which he is interested, whether directly or indirectly, or upon any matter arising thereof, and if he shall so vote his vote shall not be counted nor shall he be reckoned in estimating a quorum when any such contract, or proposal therefore, is under consideration.[46]

However, the court concluded that the benefits that the directors might acquire from the transfer agreement did not preclude them from voting on the resolution, provided that the members were properly acquainted with their personal interest benefits before voting.

This decision clarified the law in this respect, in the words of David O'Brien, Chief Executive of National Provincial, 'it leaves us exactly where we were before, but it gives us a little more confidence that we do not have to fight in a legal environment with an obvious flaw'.[47] Sir Donald's bar on cash payments to members of less than 2 years effectively precluded 27% of existing investors. So, as the above article concluded,

> societies with similar proportions of new members- such as Britannia and

[45] ibid p71
[46] Cheltenham and Gloucester Rule 30.2
[47] FT 'Building societies shake off fear of 'blackmail' John Gapper. 10 June 1994

> Woolwich- will also find take-over difficult. This appears to lessen considerably the worst fear raised by the Lloyds/ C&G deal: that it would expose other societies to a form of blackmail. Although boards of societies have no legal obligation to put offers to their members, they would be vulnerable to public debate of an offer.[48]

However, the decision in this case would only provide very limited restrictions on the benefits of carpet-bagging as it could be side-stepped by delaying the transfer or by making payments in ordinary or preference shares. As, John Wriglesworth, building societies analyst at UBS, stated, many possibilities remained open to carpet- baggers because, 'Abbey National's share distribution for its 1989 floatation was ruled legal by the courts'. [49] An assessment that proved to be correct.

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[48] ibid
[49] ibid

Cheltenham & Gloucester
Heart of England BS 2 October 1993
Rowel Regis to Heart of England 1 March 1989
Kidderminster Equitable BS to Heart of England 1 March 1989
Mid-Sussex BS to C&G 1 August 1992
Sydemham Bs to Mid Sussex 1982
Bedford Crown BSto C&G 20 July 1991
Portsmith BS to C&G BS 30 June 1991
Walthamstow BS to C&G 31 October 1990
Peckham BS to C&G 30 June 1990
Guardian BS to C&G 16 April 1990
Bedford BS to C&G 8 April 1990
Bury St Edmunds to C&G 1 Jan 1989
Bolton BS to C&G 1 October 1988
Essex Equitable to C&G 29 February 1988
Cardiff BS to C&G 29 1 October 1987
London Permanent BS to C&G 1 August 1987
Colchester BS to C&G 15 May 1987
Waltham Abbey BS to C&G 1985
Cotswold BS to C&G 1984

The National & Provincial

The National & Provincial Building Society was taken over by Abbey National PLC in August 1996. Borrowers and savers of less than 2 years received Abbey National shares worth £500 whilst savers of over 2 years received shares or cash worth £750. In addition to this, 2 year savers received bonuses according to the amount of their account balance (5% of their balance). The average payout was reported to be worth £1,400.[50] Qualifying members were those who had saved or owed at least £100 on April 1995 and December 31 1995 and held voting rights in the society. Qualifying members supported conversion in overwhelming numbers, more than 95% of those that voted were in favour of conversion.

The N&P board said they were swayed by the Abbey's offer because it, 'had given its word that there would be no compulsory redundancies in the retail network in either organisation'.[51] However, evidence would suggest that the demutualisation of the N&P was driven by the enthusiasm of its membership. As previously noted, a survey from 1988 indicated that the society's members were in support of conversion, a view that the success of the Abbey's share price can only have served to enhance. The membership in this society clearly saw their self-interest as being served by the exchange of cash for mutual status.

[50] The Guardian April 13 1996 National & Provincial Goes Overboard For Abbey Habit" Cliff Jones and Martyn Halsall

[51] ibid

National & Provincial to Abbey National PLC 1997

Hiberian BS to National & Provincial BS 1985

Burnley BS to Provincial BS 1982

The Halifax Building Society

The Halifax Building Society proposed to convert in a two-stage process. The first stage involved the merger of the Halifax with the Leeds Building Society in accordance with the provisions of section 94 of the Building Societies Act 1986 and schedule 16, effected by a transfer of engagements from the Leeds to the Halifax. The second stage involved the transfer of the merged business to Halifax plc under the provisions of section 97 BSA 1986. The Building Societies Commission required that details of the merger to be circulated to members of the Halifax and the Leeds Building Societies should contain details of the proposed transfer of business to a 'successor company'. This was in accordance with paragraph 1 of schedule 16 that required statements to include '(f) any other matters which the commission requires in the case of the particular amalgamation or transfer of engagements'. The two societies agreed to these terms and produced the terms under which the transfer to the successor company would take place. These terms gave:

> (a) a right to a fixed allocation of free shares ("the fixed share allocation") conferred on (i) all shareholding members who held shares to the value of £100 or more on 25 November 1994, who continue to hold shares until the completion of the transfer of the business to the successor company and who are eligible to vote on the shareholder's resolution to approve the transfer; (ii) borrowing members whose mortgage debt on 25 November 1994 was at least £100, who remain borrowing members until completion of the transfer and who are eligible to vote on the borrowing members' resolution to approve the transfer; and (iii) persons who were employees or pensioners of the Halifax or of the Leeds on 25 November 1994;
> (b) a right to an additional variable allocation of free shares (" the variable share allocation") conferred upon shareholding members ("two-year shareholders") who have held (or are deemed to have held) shares in the Halifax for a period of two years expiring on a qualifying day.[52]

[52] quoted in Building Societies Commission v Halifax BS [1995] 3 All ER 193 at p196

In the case of Building Societies Commission v Halifax Building Society [1995], the commission questioned the transfer document arguing that there had been an infringement of section 100(8) of the 1986 Act. This section, which, as previously noted, was the burden of the commission's case against the Abbey National, prohibited priority allocation of shares to all but '2 year members'. The commission did not, therefore, question the 'additional variable allocation of free shares to 'two-year members' but they did, however, argue that the right to acquire shares bestowed on other members was being given in priority to 'other subscribers' who, they argued were the 'investing public'. Judge Chadwick disagreed with their contention and described the meaning of the section thus. The words 'in priority to other subscribers' described and qualified the 'rights to acquire shares' subject to the restriction in section 100(8). The rights were given to those members in connection with the transfer. They could not therefore be 'investing members of the public', unless the transfer agreement proposed to offer shares to members of the public, which it did not.

> There was no one, who, in connection with the transfer, subscribed or who was entitled to subscribe to shares in the successor company other than those persons upon whom rights were conferred by the transfer agreement and who enjoyed the same rights inter se, then there could be no 'other subscribers' for the purpose of section 100(8) and no infringement of the restriction.[53]

The judge, therefore found for the defendants. The successor company was called Halifax PLC, a company that began its legal life named Listmid Ltd, a private company that was issued a certificate of incorporation on 31st March 1989. Following a special resolution, a new name, Halifax Loans (No 2) Limited, was certified on the 10th October 1989, and in October 1990, the company resolved to increase its capital from £1000 to £1,000,000, its sole shareholder, Halifax

[53] ibid p194

Building Society, having consented to this increase in writing.

In accordance with section 43 CA 1985, Halifax Loans (No 2) Limited was re-registered as a public company under the name Halifax Plc on the 4th December 1996.[54] Clause 4 of its objects stated that the company could,

- enter into a transfer agreement under section 97 of the Building Societies Act 1986 with Halifax Building Society; and,
- under that transfer agreement to assume, on the vesting date (as defined in the Building Societies Act 1986), the business of Halifax Building Society; and
- after the property, rights, liabilities and obligations of Halifax Building Society have passed to the Company under that agreement, to carry on that a business.[55]

The chairman was H.J. Foulds and J.M. Blackburn was Chief executive. Other executive directors included RF Boyes, JR Crosby, MH Ellis, GJ Fulwell, JA Lee and JR Miller.

On 24th February 1997, following a members' vote in favour of conversion, transfer documents were lodged in Companies House. In part II of the transfer document lodged in Companies House in May 1997 the reasons for demutualising were stated thus,

> As the Halifax becomes a more broadly based provider of financial services and its income from non- traditional sources increases, the board believes its business will benefit from being carried on by a company under a regulatory regime which does not require it to be a body having as its principal purpose the making of loans which are secured on residential property and which are substantially funded by members.

[54] CH form Application by a private company for re- registration as a public company Co. Co. 2367076

[55] Memorandum of Association of Halifax plc. CH

The transfer of assets from Halifax Building Society and the Leeds Building Society to Halifax plc meant that the latter was now in possession of the greater part of former building society assets. The conversion of the Halifax was the UK's biggest new share issue. In January 1997 it was estimated that the 8million members would receive £11.2billion in free shares.[56] By May of the same year, due to a combination of members holding on to their shares and institutional investors desire to purchase them, the share price in Halifax plc was 60% higher than had been predicted; 'at £7 a share, Halifax would have a market value of £17.6bn, making it the 10th largest stock on the FTSE 100 index and the country's fourth largest bank'.[57]

[56] FT January 11 1997 "Halifax unveils UK's largest new issue" Christopher Brown-Humes
[57] ibid

Halifax Building Society: Mergers

Leeds Permanent BS 1 October 1994

Southdown BS to Leeds Permanent BS 1 April 1992

Eastbourne Mutual BS transfer engagements to Sussex County BS which changed its name to Southdown BS 1 October 1990

Mitcham and Metropolitan BS to Sussex County BS 1 April 1986

Dorking BS to Eastbourne Mutual 1982

Rye Benefit BS Transfer to Eastbourne Mutual BS 1981, with the additional acquisition of

Birmingham Midshires

Harrow BS 30 April 1987

Hemel Hempstead 13 April 1987

Civil Service BS 6 April 1987

King Edward BS 15 September 1986

Birmingham & Bridgewater Bs united with Midshires BS - Birmingham Midshires 30 June 1986

Metrogas to Midshires 24 June 1986

Ealing & Acton to Midshires 1984

Severn BS to Midshires 1983

Banner to Midshires 19821

Liverpool BS to Midcourse 1982

Margie BS to Midcourse 1981

Pontardulais BS to Midshires 1981

City & District Permanent to Metrogas 1982

Queen Victoria Street to Metrogas 1982

Birmingham BS unites with Bridgewater BS to form Birmingham & Bridgewater 1982

The Demutualisation of the Woolwich Building Society and the Alliance & Leicester Building Society

> The hottest tips in the conversion stakes are Woolwich and Alliance & Leicester, both of which are likely to announce plans to become public limited companies early next year at the latest.[58]

Woolwich Building Society

On 6 January 1996, the Woolwich Building Society announced it would become a bank. With 3.5 million qualifying members the estimated payout was expected to be around £500-£700, with larger amounts for long-term savers. The conversion plan was not expected to be approved until April 1997, although the Woolwich executives had hinted that they would follow a similar conversion plan to that of the Halifax, which would give extra share distribution to high, long term savers.[59]

The cut- off time for qualification was 31 December 1995, thus some commentators argued that there could be opposition to the terms of the conversion from the 40,000 or so investors who opened accounts after this date.[60] The number of investors in the Woolwich had greatly increased during 1995, following speculation about demutualisation, which led to the Society raising its minimum opening balance to £500. This relatively small amount, however, did little to arrest the enthusiasm for joining the society. Carpet-baggers would inevitably have a huge interest in a

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[58] p6 Allyson Smith 11 Nov 1995 "Are Mutuals Friendless?

[59] (b) a right to an additional variable allocation of free shares (" the variable share allocation") conferred upon shareholding members ("two-year shareholders") who have held (or are deemed to have held) shares in the Halifax for a period of two years expiring on a qualifying day.' (quoted in Building Societies Commission v Halifax BS [1995] 3 All ER 193 at p196

[60] 13 January 1996 Financial Times "Weekend Money (personal Finance): Woolwich converts, who will be next?- Martin MacConnol"

society whose assets were valued in 1995 at £26.69 billion, making it the third richest mutual building society after the Halifax's £92.77 billion and the Nationwide's £35.74 billion.

It was chiefly size that led Peter Robinson, Woolwich's Chief Executive, to conclude that the society's best interests would be served by demutualisation. In the wake of the Woolwich's conversion, he argued, there remained a place for small, regionally based societies who dealt in a small number of financial products. However, this was not a route that the larger societies could afford to pursue, 'large players could not rely on organic growth alone to maintain their relative positions, and would need to merge or make acquisitions to do so'.[61] As the Financial Times noted, this was becoming a popular view among the upper echelons of the building society movement.

> Despite the merger announced last week between Stroud & Swindon and City & Metropoliton- much smaller societies- few in the sector would disagree with his view that the traditional merger between large societies is no longer an option. The argument is that savers and borrowers want deals that enable them to realise the value of their membership, as a flotation or take-over would do, and a merger would not.[62]

[61] FT Alison Smith 12 Jan 1996 UK Company News: How the building of banks has altered the view.
[62] ibid

Woolwich Building Society: Mergers
Town & Country BS 2 June 1992
Woolwich Equitable 6 June 1990
Gateway BS to Woolwich Equitable 31 June 1988
Property Owners BS to Woolwich Equitable 1 December 1986
Grangemoth BS to Woolwich Equitable 1983
North Kent BS to Woolwich 1985
Lord Grosvenor Bs to Woolwich 1984
New Cross to Woolwich 1982

The Alliance & Leicester

> Peter White, Chief Executive of Alliance & Leicester, personifies a predicament. While the A&L has not said that it intends to become a bank, it remains high on the list of those rumoured to do so. White is due to become chairman of the Building Societies Association next May. But perhaps even as he begins his year in office, A&L will be on its way out of the sector.[63]

In response to the demutualisation of the C&G and the value of assts believed to be distributable to members, Peter White said that it was important to continue the strategy the group had been developing. Ultimately, he continued this strategy with the same degree of commitment to mutuality as Mike Blackburn, chief executive of Halifax Building Society, who said back in 1994, 'the last five years results have clearly demonstrated our ability to compete effectively as a mutual with the best in the financial services industry'.[64]

On the 31 January 1996, the A&L announced its intention to float on the stock market and its Chairman, Simon Everard, estimated that the flotation would value the company at between £2.5 and £3 billion , making it the fourth largest building society to shed its mutual status. The reason given for conversion was stated thus, 'as a substantially capitalised, publicly-listed financial services group, the Alliance & Leicester will be able to compete across a wide range of personal and corporate financial services market'.[65] The cut- off period was 31December 1995 so 'speculators who joined up between January 1 and 14 when the society closed its share accounts- will be barred'.[66] This was arguably a very short, almost token cut-off period and

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[63] FT Allyson Smith 9 Aug 1995 management: Firming up the Foundations- The trade associations representing building societies

[64] FT Alison Smith 22 April 1994 Lloyds/ Cheltenham & Gloucester: Rest of Sector given something to think about

[65] 31 Jan 1996 City: Millions Bank On Shares Bonanza As Alliance Goes Public: Press Association Philip Thornton and Nick Hudson

[66] ibid

merely excluded the less organised carpet- baggers as the Alliance & Leicester was one of the first societies to admit an interest in conversion. As the Financial Times noted as far back as 1989, 'at present only two societies, National & Provincial and Alliance & Leicester, admit to considering incorporation, compared with about half a dozen this time last year'.[67]

Alliance & Leicester
Alliance BS united with Leicester BS to from Alliance & Leicester 1985
Boston & Skirbeck transfer to Leicester BS 1984

Bristol & West Building Society

On April 14 1996 the Bank of Ireland announced its plans for a £700 million takeover of the Bristol & West Building Society. It spent just one week refusing to accept new savers on their share account in order to stem the rabid flow of potential carpet-baggers responding to takeover rumours in the press. Alex Brummer, prompted by news of the takeover, wrote that the, 'history of encouraging prudence and sound money has been wasted in a few years by a Conservative administration insensitive to the movement and apparently hell-bent on creating a group of financial behemoths able to run roughshod over stakeholders, whether investors or employees'.[68]

However, 'the movement', at least within the membership of the Bristol & West, seemed more

[67] FT Davis Barchard 3 May 1989 Seeking Survival In Demanding Times: The Problems which deregulation pose for UK Building Societies
[68] Alex Brummer "Tories Build on Mutual Bonanza" The Observer April 14 1996

than willing to avail themselves of the legislation of the insensitive Conservative administration. When the Bristol & West held a special meeting at the Royal Bath and West of England Society Showground in Shepton Mallett in order to seek member's approval of the proposed merger with the Bank of Ireland group, the Glasgow Herald reported that members had, 'voted overwhelmingly in favour of the proposed combination' with 84% of its members voting on the ballot.[69] This percentage represented 600,000 of the Bristol and West's membership, of which 96% voted in favour.[70] The differential rewards for members upon merger meant that savers received £1,000 in cash and borrowers received 250 preference shares estimated to be worth £1 each. Two- year members, defined by the board as savers who were members from the end of 1994 and who had at least £100 invested on April 1996 and December 31 1996, would receive a cash payment of £500.[71] However, the more meager rewards for borrowing members did little to deter their enthusiasm for the terms of the merger.

The demutualisation of the Bristol & West, like that of the N&P seems to have been driven by the enthusiasm of the membership. The management, displaying none of the vigorous determination of the Abbey's management, maintained a luke-warm and pragmatic approach to the demutualisation process, commending it when they were clear that little would change in the society's internal organisation. Thus, the board advocated merger following the, 'Bank of Ireland's promise to retain existing staff and management, and preserve B&W as a separate company with its own branch network'.[72]

The management had made some attempt to inhibit the swamping of its membership with carpet-

[69] The Glasgow Herald April 16 1997 "Support for conversions"
[70] John Givens, "Members in the Street Opting to Take the Windfall and Run" (reported in The Guardian April 19 1997,
[71] Krishna Guha "Savers Strike it Rich" FT March 1 1997
[72] ibid

baggers by closing its doors to new savers wishing to open share accounts. Despite this, the membership of the Bristol & West, like the other converting societies before it, saw their self-interest as being served by the exchange of mutual status for cash.

Bristol & West
Chesthunt BS 30 December 1991 Aid to Thrift BS to Chesthunt 11 July 1988 Thift BS to Chesthunt 13 April 1987

Northern Rock

The conversion in 1997 of Northern Rock Building Society was approached in a measured and uncontroversial manner. Managing director Chris Sharp described it thus, 'the route to conversion is hard work but we are making good progress. Watch this space'.[73] A stockbroker, Hoare Govett Corporate Finance, was appointed a year before the stock was floated and Northern Rock's members were keen to convert, and of those borrowing and investing members who voted in the ballot for demutualisation, 97% were in favour. Conversion gave 500 free shares to its members that were, at the time of voting, estimated to be worth between £1300 and £1475, with the Society itself being valued at around £1250 million. Its chairman, Robert Dickenson, was reported as saying that the society was, 'extremely pleased' that so many members took part in the vote and that the conversion proposals received such overwhelming backing'.[74] Northern Rock Building Society would not convert into a bank until October 1997 whereupon all members would receive 500 shares.

Following the ballot, Northern Rock announced a 27 percent decline in pre- tax profits to £62.9 million. The cost of conversion was reported to be over £9 million and the amount lent following the ballot fell from £1.1billion to £794 million.[75] But, Northern Rock's executives were extremely keen to retain their position and thus avoid being taken over. Executive director David Baker, stated, 'we hope that our performance for shareholders will ensure our continued independence'.[76] So, for this reason, coupled with the problem of fluctuating profits leading up

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[73] Colin Tapping quote from The Northern Echo July 24, 1996, "Record-Breaking Rock Stays On Flotation Track"
[74] The Glasgow Herald April 16 1997 "Support for conversions"
[75] Caroline Merrell). "Northern Rock Float Costs £9 million" The Times July 24 1997
[76] ibid

to conversion, the society decided to hold only one auction for their shares. In contrast, the Halifax, Alliance and Leicester and the Woolwich building societies all held at least three auctions, despite evidence that auctions tended to cause sharp fluctuations in share prices with large differences between the price at auction and the price on the market. Northern Rock attempted to avoid the possibility of price manipulation by holding one auction the day before the listing of its stock on the market, disclosing the price just before trading began.[77] By September 27th the windfall accruing to members 500 shares was estimated to be worth about £2,100.[78] Following floatation on the market the windfalls were worth £2,300, with the share value peaking at 470p, far in excess to the 295p predicted in conversion documents sent to the society's members in February 1997.

The membership had little desire to retain any ownership rights in Northern Rock PLC and most members preferred to cash- in their shares, 43% of members selling at the auction. Commentators attributed this to the mentality of the North East of England. Adam Applegarth, Executive Director was reported as saying, 'Geordies prefer cash'.[79] Yet, as the evidence above indicates, Geordies may love cash but so did the vast majority of the building societies movement membership in 1997.

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[77] FT September 2 1997 "Northern Rock plans one auction of shares: Single sale intended to avoid sharp fluctuation in prices"
[78] FT September 27 "More than 43% to cash Northern Rock shares" Christopher Brown-Humes
[79] The Times October 4 1997 "The Floating of the Rock" Caroline Merrell

Northern Rock

North of England BS- 1994

Surrey BS-1993

Lancastrian BS- 1992

Wishaw Investments-1987

United Kingdom BS-1987

Hartlepool & District BS- 1985

Manchester Unity of Odd Fellows- 1985

South Shields Sun Permanent Bs-1985

Masselburgh BS- 1983

Blyth & Morpeth BS- 1982

Kilmarnock BS- 1982

Shields & Washington BS- 1982

Pioneer BS-1981

Stockport & County Permanent BS- 1981

Lancashire BS- 1980

Walker & Byker Industrial Permanent BS- 1980

Northern Counties BS and Rock Permanent Merged to form Northern Rock-1965

Conclusion:

The conversion of the Abbey National Building Society could have operated as a salutary experience for those who wished to preserve mutuality, leading to a pro-active campaign to inhibit conversions. Instead, as the Abbey National continued to be successful[80], mainly due to the buoyancy of the mortgage lending business, so larger building societies continued to consider conversion a viable option. And, despite the ample time available between the Abbey National's conversion and the huge spate of conversions in 1997, little was done either by Parliament or by those heading the building society industry, to protect, or promote mutuality. In particular, members' appreciation of mutuality did not increase, on the contrary, members voted in overwhelming numbers for the conversion of their society, with votes in favour being almost unanimous in the ballot for the Bristol and West merger and the Northern Rock conversion. Furthermore, it had become clear from the judicial decisions noted, that the Building Society Act 1986 held precious few protections against conversion when such large majorities of members were in favour of demutualisation. Conversion remained popular even in the absence of the spectacular rewards offered by conversions like the Halifax conversion, as the modest amounts accruing to Bristol & West borrowers testify. Mutuality had been neglected and now it was scorned, its preservation would depend on a transformation in executive, judicial, governmental and, particularly, membership attitude toward it. It is to a study of these attitudes that this thesis will now address itself.

[80] The Abbey National entry into the state agency business had actually resulted in losses according to a report in 1994.

CHAPTER 5 PUBLIC ATTITUDES TO MUTUALITY

Introduction

Survey 1997

Survey 2000

Conclusion

Public Attitudes to Mutuality

As shown in the previous chapter, 1997 saw a huge decrease in building society assets as the largest societies, Northern Rock, Bristol and West, the Woolwich, Alliance & Leicester and, most significantly, the Halifax converted into PLCs.[1] The 1997 Building Society Association's Annual Conference in Brighton reflected this abrupt change of fortunes, with much discussion about the need to adopt more convincing strategies to maintain member loyalty to societies in their existing legal form and, in particular, to thwart carpet-baggers. Interviews with delegates during the conference displayed an even greater sense of urgency and frustration that too little was being done, too late, to save the movement from being swallowed up by the corporate form.[2]

On the conference floor there was much discussion on the need to curb carpet-bagging, largely considered to be the greatest threat to the preservation of building societies. Dr Geoffrey Fitchew, Chief Registrar of the Building Society Commission, argued that the passage of the 1997 Building Society Act had gone some considerable way toward the protection of mutuality as, to a large extent, its more permissive regime allowed societies to construct their own powers under their rules and memorandum. Though short on specifics, Dr Fitchew called for a general demonstration of the benefits of mutuality.

[1]The Bristol & West transferred its interests to the Bank of Ireland.

[2] The writer undertook a number of informal interviews with chief executives at the 1997 BSA Conference.

In addition to this, two outside speakers argued in favour of mutuality and outlined the methods by which members could be persuaded to concur with these views.

Sheila McKechnie, Chief Executive of the Consumer Association, stated that there were considerable benefits for the consumer, both as members of mutual societies and as consumers, in an environment where mutuals existed as part of the competition for financial services. Demutualised societies, she argued, suffered by introducing an additional stakeholder - the shareholder - who demanded a large proportion of profit. Ms McKechnie went on to cite the Abbey National as an example of a demutualised society that paid out 40% of its profits as shareholder dividends and had closed branches to cut costs and enhance profits, effectively, 'excluding customers'.[3] She further argued that 'they, (public limited companies) are hindered from offering competitive lending and borrowing packages to customers . . . . . . mutuals do not offer dividends to their members therefore they were able to offer more competitive rates than banks'.[4] To illustrate this latter point, Ms McKechnie outlined a study undertaken by the Consumer Association, which revealed that mortgages offered by High Street building societies were, on average, £1,600 cheaper than banks when summed over a 5-year period. Mortgages from smaller societies were even cheaper.

Dr Beard from the Henley Centre proffered a study undertaken on awareness and understanding of mutual status and concluded that mutual societies needed 'new packaging' that focused less on ownership and more on the benefit of investing and borrowing from a mutual. In his view there had been a general shift in public values over the last 10 years and a reorientation toward community values, placing collective before individual interests. However, the reverse was true

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[3] BSA conference 1997
[4] ibid

when acting as consumers; here concerns were 'individualistic, demanding and self-interested'[5]. There was, he argued, a fall in trust and faith in traditional institutions due to the visible 'fallibility of the expert' and a 'decline in deference'. This gave 'new opportunities for outsiders' diminishing the traditional barriers to entry and therefore providing more access for women and ethnic groups.

In terms of strategic advice, Dr Beard argued that building societies should dispel their 'old fashioned' image in favour of 'the more desirable image of tradition or heritage'. He further advised societies to, 'enhance employer flexibility, acknowledge the fact that the consumer considers profit to be both acceptable and desirable, create innovative products and develop a relationship between consumers and producers'[6]. The first and last of these points could be neatly encompassed in the concept of mutuality, which is both traditional and highlights relationships within a mutual society. Mutuality, then, could be viewed as good 'product'.

In another session, John Heaps, Deputy Chair of the BSA and Chief Executive of the Britannia discussed what he called the, 'virtuous circle of mutuality'. Increased profitability would increase member's 'profits', which would increase the number of satisfied customers which would mean more business and increased profitability and so on. Based on the results from focus groups and questionnaires, the Britannia had constructed a 'members loyalty scheme' whereby members would receive a 'point' for every pound paid on their mortgage, a scheme he recommended to other societies.

Elsewhere, at the conference, delegates discussed the importance of emphasising the difference

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[5] ibid
[6] ibid

between a mutual society and a PLC. The Abbey National, many argued, had continued its success as a mortgage lender as it had continued to look like and act like a *mutual* building society. To outside observers, the only difference in the Abbey National following conversion was that its members had received a cash bonus. As demutualisation appeared desirable a mutual society could only avoid conversion by learning to underline the distinct nature of mutuality and its benefits over the corporate form. In the words of John Cheele, executive of Kent Reliance Building Society,

> Members of societies were unaware of their rights, management has been too distant from the membership. Now they are becoming aware of their rights, they wish to exercise them for financial gain, and who can blame them - a company appears to them to be no different from building society.[7]

The key theme of the 1997 conference, *Shaping up for the Future*, was the necessity to find and exercise strategies to articulate the nature and benefits of mutuality. By this method, member's active support of mutuality could work as a bulwark against the activities of carpet-baggers. How successful these strategies were is assessed in the following survey.

The following surveys were conducted in Brighton, London and Canterbury, during July and August of 1997, and again in the same locations and during the same period three years later.[8] In each case, the survey was undertaken in a busy commercial area on streets with a substantial building society presence.[9] The surveys were undertaken on weekdays and, in total, fifty questionnaires were taken in each location and on each occasion. The complete study involved a

[7] John Cheele in interview at the 1997 BSA conference.

[8] These locations were selected for the convenience of the writer who lives and works in these areas

[9] Canterbury: High Street
Brighton: Western Road
London: Camden High Street

total of 300 questionnaires.

The survey was designed to assess individual's knowledge of building society's mutual status and their allegiance to their own building society. The surveys were taken three years apart in order to assess how successful building societies had been in promoting the meaning and desirability of mutual status.

The questionnaire was first tested on a small focus group of six people in order to address any problems such as repetition or contradictions. The questionnaire proceeded as follows.

1. Are you a member of a building society?
2. What do you understand by mutuality?
3. If your building society proposed becoming a bank, how would you vote?
4. Why would you vote this way?

Problems:

Question 1: *Are you a member of a building society?*

This seemingly uncontroversial question was confused by the way in which many people consider building societies to be building societies whether or not they possess the letters plc after their name. This became problematic when the interviewer came to question 3. "If your building society proposed becoming a plc how would you vote?"; as a number replied that the motion to convert had already taken place. However, if the interviewer had attempted to clarify the situation by for instance asking the question, "are you a member of a *mutual* building society?" this would have rendered the survey and in particular question 2 redundant as it would have alerted the interviewee to the notion of mutuality and would probably have necessitated explanation of the term itself. Conversely, some interviewees replied 'no' because they belonged to a building society that had demutualised.

The phrase, "are you a member of a building society" could be retained if the connecting questions were refined. Whether the answer was "yes" or "no", the interviewer would have a correlating question. If the answer was yes, but the society had already voted to demutualise, the interviewer could move onto a appropriate question. These changes would be incorporated in a new question four which would contain three parts.

4. (a) If answer to question 1 was 'yes, I am a member of a building society' then ask, "has your society voted on the issue of becoming a plc?"

(i) If the answer is 'yes, my building has voted to become a plc', then ask "How did you vote?"

1. Voted in favour.
2. Voted against.
3. Did not vote.

4. (a)(ii) If the answer is 'no, my building society has not voted on the issue of becoming a plc', then ask "If your Building Society proposed becoming a plc how would you vote?"

1. In favour of becoming a plc
2. Against becoming a plc
3. Would not vote

4. (b) If answer to question 1 was 'no, I am not a member of a building society' then ask "If you were a member how would you vote?"

1. In favour of becoming a plc
2. Against becoming a plc
3. Would not vote.

Question 4(b) allowed the survey to gauge the opinions of the general public who were not members of a building society.

2. *What do you understand by mutuality?*

In this form, the question appeared disconcertingly intellectual and seemed to require an accurate definition from the interviewee or nothing at all. It therefore failed to engage in what the interviewees actually did understand about mutuality. It emerged that the term 'mutual' in some form was familiar in different ways to different interviewees. Some understood the term mutuality as it stood, but others only made sense of it when it was accompanied by the term mutual status. Other responded to the accompanying term 'demutualisation'.

Question 2 was henceforth reformulated to include the additional phrases 'mutual status' and 'demutualisation'. Secondly, this question was followed by the more open question, 'what do you understand by this term', thereby allowing interviewees to free associate those concepts that they connected with mutuality. This was now contained in question 3. For those interviewees who did not understand these terms, the interviewer fully explained the nature of conversion until an understanding was reached.

3. *If your building society proposed becoming a plc, how would you vote?*

This question was now subsumed in the new question 4.

4. *Why would you vote this way?*

Responses to the question were often twofold because although the general response was a vote in favour of demutualisation, this was, in the case of the focus group, entirely guided by the prospect of 'windfall shares'. The accompanying response to this answer was one of regret and a clear view that mutual building societies that were not plcs were a good thing. As the purpose was to assess public knowledge and allegiance to mutuality it was preferable to organize questions in such a way as to allow views on mutuality to be separated from views on financial reward (which followed a vote to shed mutual status). Thus, two additional questions were put at the end of the survey. Firstly, "Do you think that organisations with mutual status are worth preserving?", and, secondly, "Why do you think this?" (question 5 and 6 respectively)

In general, the survey was reconstructed in order to accommodate the problems identified by the focus group and to allow interviewees that had an opinion on building societies, and of building societies becoming plcs, to be incorporated, notwithstanding that they were not members of a building society. The survey also allowed for some clarification of the term mutuality to be included.[10]

[10] The full survey is held in appendix 2

1997 Survey

The condensed results contained in the following tables are expressed in percentages of either the whole survey or the category that was being asked that particular question. Not all interviewees were asked same question. For example, interviewees that replied that they were not members of a building society would not then be asked how they would vote within their building society, but were instead asked how they would vote *if* they were members of building societies.

Question 1: Are you or have you ever been a member of a building society?

Q1 membership	Canterbury	Brighton	London
% YES	76	84	72
% NO	24	16	28

percentage of all interviewees

Occasionally, interviewees answered 'don't know, this was recorded as 'no'.

Question 2: Have you heard the term mutuality, demutualisation or mutual status in the context of building societies?

Q2 knowledge	Canterbury	Brighton	London
% YES	68	84	80
% NO	32	16	20

percentage of all interviewees

Question 3: What do you understand by mutuality?

Q3 understanding	Canterbury	Brighton	London
nothing	16	0	16
no shareholders	52	68	52
borrowers & lenders	0	32	28
non profit making	40	16	12
run for members	36	16	28
owned by members	28	56	28
members voted	28	32	40
one man one vote	4	0	0

percentage of particular category

This question invited the interviewees to talk about their general understanding of mutuality or mutual status allowing the interviewer to note down the many points that were made. These discussions were later categorised under the nine different headings noted above. Generally interviewees had more than one notion of mutuality and it is these that are noted. Only those who did not respond in the affirmative to Question 2 were not asked this or any other question.

Question 4: How would you/did you vote in a motion to demutualise?

4(a) (i) "Yes I am a member of a building society"
Affirmative, building society has voted to demutualise

Q4(a)(i) voting	Canterbury	Brighton	London
voted in favour	20	24	24
voted against	0	8	4
did not vote	16	16	12
number of interviewees	eighteen	twentyfour	twenty

percentage of all interviews

Q4(a)(i) voting	Canterbury	Brighton	London
voted in favour	56	50	60
voted against	0	17	10
did not vote	44	33	30
number of interviewees	eighteen	twentyfour	twenty

percentage of given category

Question 4(a) (ii) Negative, building society has not voted to demutualise

Q4(a)(i) voting	Canterbury	Brighton	London
would vote in favour	70	56	75
would vote against	20	22	25
would not vote	10	33	0
number of interviewees	twnety	eighteen	sixteen

percentage shown of category 4 (a)(ii)

4(b) (Hypothetical) "I am not a member of a building society" "How would you vote"

Q4(b) hypothetical voting	Canterbury	Brighton	London
would vote in favour	16	4	12
would vote against	4	4	8
would not vote	4	8	8
number of interviewees	twelve	eight	fourteen

percentages of all interviews

Q4(b) hypothetical voting	Canterbury	Brighton	London
would vote in favour	67	25	43
would vote against	17	25	29
would not vote	17	50	29
number of interviewees	twelve	eight	fourteen

percentage shown of category 4(b)

Question 5: Do you think that organisations with mutual status are worth preserving?

Q5 worth preserving?	Canterbury	Brighton	London
YES%	36	48	36
NO%	32	36	44

Response from those who were members of building societies, expressed as a percentage of all the interviews

On average 40% of those interviewed thought that mutuality was worth preserving and 37.3% of those interviewed thought it was not worth preserving.

Question 6: Why do you think that mutual status is worth preserving?

Q6 why preserve mutuality?	Canterbury	Brighton	London
traditional	8	8	8
competition	16	24	20
cheaper mortgages	24	36	20
democratic	0	4	8
personal service	8	4	4
good for small savers	8	12	12
total number in the affirmative	eighteen	twentyfour	eighteen

percentages of all interviews

Q6 why preserve mutuality?	Canterbury	Brighton	London
traditional	22	17	22
competition	44	50	56
cheaper mortgages	67	75	56
democratic	0	8	22
personal service	22	8	11
good for small savers	22	25	33
total number in the affirmative	eighteen	twentyfour	eighteen

percentage of this category

Mutuality is not worth preserving: Reasons

Q6 why end mutuality?	Canterbury	Brighton	London
slow & old fashioned	24	16	24
uncompetative	12	20	16
indifferent to organisational form	4	81	12
total number in the negative	sixteen	eighteen	twentytwo

percentages of all interviews

Q6 why end mutuality?	Canterbury	Brighton	London
slow & old fashioned	38	44	55
uncompetative	12	33	18
indifferent to organisational form	50	22	27
total number in the negative	sixteen	eighteen	twentytwo

percentage shown as a proportion of this category

Conclusion:

Perhaps because of the proximity of the interviews to building society branches, or perhaps because the surveys were conducted during a weekday (when building societies would be open all day), in all three cities, a large percentage of those interviewed *were* members of building societies. Indeed, in all three cities over three quarters of those interviewed owned a building society account. In addition to this, a high percentage of the sample had some cognizance of at least one of the terms 'mutuality', 'demutualisation' or 'mutual status' in the context of building societies. The smallest percentage was in Canterbury at 68% of all those interviewed, the highest being Brighton at 86%. The questionnaires therefore signified that a high percentage of the sample were connected to building societies (average 77.3%) and /or had some recognition of the aforementioned terms (average 77.3%).

The results of Question 3 indicated that mutuality was understood in terms of its difference to the corporate form. A highly visible characteristic of companies is the existence of shares and shareholders; the most common understanding interviewees had of mutuality was that it meant an absence of these two corporate features. Thus, 57.3% of those interviewed understood mutuality as meaning an absence of shareholders and by implication, shares.

The second most popular understanding of mutuality, on average held by 37.3% of interviewees, was that a society was owned by its members. This was a significant number, given that it has been argued that one of the major factors in the move to demutualise was members' alienation from their building society because it appeared to be just another large, faceless financial organisation. On closer examination, it emerged that this particular insight was, ironically, derived from the process of demutualisation itself. The logic of this was that if members of demutualising building societies were receiving 'windfall shares', gratis, then they were being recompensed for the value of ownership of a part of that organisation.

The educative nature of the highly publicised demutualisations was further apparent in the third most popular understanding of mutuality, the fact that members voted. The notion of voting is an issue that has been highly published in the context of demutualisation where member's votes are pivotal to demutualisation in the context of section 97 of the Building Societies Act 1986.

The answers to Questions 3 and 4 provide the greatest insight into how successful mutual societies have been in promoting the unique and desirable qualities of mutuality. The notion that building societies were "non profit making" was understood by an average of 22.7% of those asked. This obviously strikes at the core of the message that building societies wished to communicate ie that building societies had a social function and that membership of a mutual was a rational choice. This, coupled with the fact that 27% of those asked understood mutuality as meaning that the organisation was run for the benefit of members indicated that at least 25% of the interviewees thought that mutuality held positive benefits for members.

A sizeable 20% of those interviewed thought that mutuality meant that there were both borrowers and savers within the organisation. This indicated a more sophisticated understanding of mutuality but did not, of itself, indicate whether this was considered a positive or negative attribute of mutuality.

Question 4(a) related to those interviewees that were members of building societies that had voted to demutualise. In Canterbury, this accounted for 36% of those interviewed, in Brighton, 48%, and in London, 40%; in total 41% of all those interviewed and 46% of those who continued to be interviewed after question 2. Of this category, 36% did not vote at all, 55% claimed to have voted in favour of demutualisation, whilst only 9% claimed to have voted against the motion to demutualise. As a percentage of all interviews, 22.7% voted in favour, 3% voted against and 14,6% did not vote at all. In other words only three people in the total survey for 1997 chose to vote against this motion despite the fact that 34 people thought of building societies as non profit making and 40 people thought they were run for the benefit of members. Notwithstanding that this category represented only 46% of those who continued to be interviewed, there was still a considerable discrepancy between an articulate and positive view of mutuality and an active attempt (in the form of a vote) to maintain the mutual status of the societies concerned.

Question 4(a)(ii) related to those interviewees who were members of a building society that had not yet voted to demutualise. The numbers here were surprisingly high given the number of building societies that had demutualised by this date (approximately 60% of building society assets); Question 4(a)(ii) accounted for 36% of the total survey and 40.3% of those who continued to be interviewed after Question 2. The first thing to note about these interviews is that only a very small percentage of interviewees said that they would not vote in a motion to demutualise (5% of all interviews) therefore the percentages of individuals voting for or against demutualisation are greater than in Question 4(a)(i), although, as voting behaviour in general suggest more people intend to vote than actually succeed in doing so. This notwithstanding, a huge 66.7% of those in this category said that they would vote in favour of demutualisation, representing 24% of all interviews taken. Only 14% of this category said that they would vote against the motion, just 8% of all interviews.

Question 4(b) asked the hypothetical question, "How would you vote?", and accounted for

22.7% of all interviewees. 32% of this category said they would not vote in a motion, a much higher percentage than for question 4(a)(ii) but was still lower than those answering Question 4(a).

The most popular view by this group was that they would vote in favour of demutualisation, (45%) which accounts for 10.7% of the whole survey. Only 23.7% of this group said they would vote against the motion, a number representing 5% of all those interviewed.

Thus we can see that the majority of individuals would vote or had already voted in favour of demutualisation vote and in this hypothetical vote 65.7% have voted. As, 75% of investors and 50% of borrowers are required to vote in favour of a resolution to convert to a plc.; in this hypothetical vote, 74.1% would vote in favour, and, given a reasonable percentage of borrowers voting this would most certainly allow conversion to take place.

	voted in favour	**voted against**	**did not vote**
category 4(a)	14.7	4	22.7
category 4(a)(i)	24	8	5
category 4(b)	10.7	5	7
total	48.70%	17%	34.70%

To the question, 'Do you think that organisations with mutual status are worth preserving, on average 40% of those interviewed replied in the affirmative but 37.3% of those interviewed thought it was not worth preserving. Although nearly half would vote to end the mutual status and 34.7% were not sufficiently concerned to vote (a total of 83.4%), a significant proportion thought that, at least in theory, mutuality was worth preserving. This would suggest two things. Firstly, that mutuality was not sufficiently important for members or hypothetical members to actively preserve it, and secondly, it was not sufficiently important for members to forego the financial rewards accruing to them upon demutualisation.

In the study as a whole, the reasons for supporting mutuality were as follows.

	average % of study	average % of category
traditional	8	30
competition	20	50
cheaper mortgages	27	66
democratic	3	10
personal service	5	14
good for small savers	11	27
% in the affirmative	40	

NB Interviewees often gave more than one response. It is the responses that are recorded.

Clearly, the most positive reasons for maintaining mutual status were that their existence maintained competition in the financial market and that they provided cheap mortgages. This indicates a very pragmatic approach to mutual status, mutual societies ensured cheaper financial products by firstly providing them and secondly forcing competitors to follow suit. Yet, it was not necessary that all mutual societies remained (hence many of these interviewees had already voted to demutualise) just that enough remained to enable competition. The sorts of things that the BSA were anxious to promote, such as the 'personal touch', scored very low on the survey, the latter three categories accounting for only 6.3% of responses. That mutual societies were 'traditional', was not of great significance to interviewees. The preservation of mutual societies *per se*, in the eyes of the sample would have to be justified by observable benefits.

The results of Question 6 in respect to those not wanting to preserve the mutual status of building societies were indicative of societies' collective failure to promote a modern commercial image. It also indicates a failure by societies to address their critics, as societies continued to be perceived as possessing overcautious and often prejudicial attitudes to potential borrowers.

	average % of study	average % of category
slow & old fashioned	17	46
uncompetitive	16	21
indifferent to organisational form	8	33
% in the negative	37	

percentages as total of whole survey and of particular category

To summarise the conclusions of this first study, we can see that the very act of demutualisation by societies, particularly large societies such as the Halifax, had served to educate members on some of the attributes of mutuality. Previous studies suggested that knowledge of the attributes of mutuality were still very unformed.[11] However, an enhanced insight into the nature of mutuality did not result in a direct commitment to its preservation when he benefits of conversion for members were so immediate and tangible.

[11] Henley Centre op cit

2000 Survey

Question 1: Are or have you ever been a member of a building society?

membership	Canterbury	Brighton	London
YES	72%	64%	56%
NO	28%	36%	44%

percentage of all interviews

Again, if interviewees answered 'don't know' this was recorded as 'no'.

The number of interviewees who were members of building societies in 2000 were slightly down on the figures from 1997, although the vacinity in which the interviews were undertaken had been shown in the previous survey drew a large proportion of building society members.

2. Have you heard the term mutuality, demutualisation or mutual status in the context of building societies?

knowledge	Canterbury	Brighton	London
YES	88%	88%	88%
NO	12%	12%	12%

percentage of all interviews

In all three cities, more interviewees in the 2000 study had some acquaintance with these terms than the previous 1997 interviewees. In Canterbury 20% more interviewees had knowledge of these terms, in Brighton this figure was up 5% and in London there was an increase of 8%, indicating that either or both the efforts of building societies and the media to elucidate the notion of mutuality had been successful.

Question 3 “What do you understand by mutuality?

Q3 understanding	Canterbury	Brighton	London
nothing	4%	0	4%
no shareholders	56%	68%	76%
borrowers & lenders	16%	24%	16%
non profit making	56%	52%	40%
run for members	36.00%	52%	48%
owned by members	44%	40%	32%
members voted	28%	24%	12%
one man one vote	0%	0%	0%

percentage of a given vote

This question invited the interviewees to talk about their general understanding of mutuality or mutual status allowing the interviewer to note down the many points that were made. These discussions were later categorised under the nine different headings that were constructed in the first 1997 survey. Generally interviewees had more than one notion of mutuality and it is these that are noted. Only those who did not respond in the affirmative to question 2 were not asked this question.

Like the 1997 study, the most popular understanding of mutuality in the context of building societies was that there were no shareholders, in 1997 this accounted for 57.3% of interviews. In 2000, this accounted for exactly two third of all those interviewed. Less popular was the view that mutuality indicted a financial institution that encompassed both borrowers and lenders, standing at 18.6%, it had dropped by 4%. Likewise, the fact that members voted was only noted in 21.3% of interviews in 2000 compared to 33.3% in 1997.

The significant shift occurred in the two answers that were previously identified as being the most significant in term of indicating an appreciation of mutuality as something beneficial, answers three and four. 49.3% of interviewees said that mutuality meant that the organisation was non profit making, an increase of nearly 27% from 1997 and 45.3% thought that mutuality indicated an organisation that was run for the benefit of its members, an increase of nearly 19% from the previous survey. It appeared therefore that the interviewees increasingly considered that mutuality was something with positive attributes and one that perhaps should be maintained.

Question 4: Are you a member of a building society and if so has it voted on the issue of becomig a plc?

4.(a) "Yes I am a member of a building society"

Q4(a) voting	**Canterbury**	**Brighton**	**London**
voted in favour	16%	20%	8%1
voted against	8%	4%	0%
did not vote	20%	28%	24%
number of interviewees	twenty two	twentysix	sixteen

percentage of all interviews

Q4(a) voting	Canterbury	Brighton	London
voted in favour	36	39	25
voted against	18%	8%	0
did not vote	46%	54%	75%
number of interviewees	twentytwo	twentysix	sixteen

percentage of given category

Question 4(a) (ii) How would you vote?

Q4(a)(i) voting	Canterbury	Brighton	London
would vote in favour	12	8%	12
would vote against	8	4	8
would not vote	8	0	4%
number of interviewees	fourteen	six	twelve

percentage of all interviews

Q4(a)(i) voting	Canterbury	Brighton	London
would vote in favour	43	67	50
would vote against	29	33	33
would not vote	29	0	17
number of interviewees	fourteen	six	twelve

percentage of given category

4(b) (Hypothetical) "I am not a member of a building society" "How would you vote"

Q4(b) hypothetical voting	Canterbury	Brighton	London
would vote in favour	16	16	20
would vote against	12	16	16
would not vote	0	4	8
number of interviewees	fourteen	nine	eleven

percentages of all interviews

Q4(b) hypothetical voting	Canterbury	Brighton	London
would vote in favour	57	44	46
would vote against	42	441	36
would not vote	0	11	18
number of interviewees	fourteen	eighteen	twentytwo

percentage shown of category 4(b)

The significance of question five is that it indicates an increasing aversion to voting in favour of demutualisation. For those who belonged to building societies that had not yet chosen to demutualise, 31.7% (on average) said that they would vote against such a motion. As 85% (on average) said that they would vote, the 'no' vote would represent 37.3% of the total. If the majority of voters were investors, this would be insufficient to allow conversion. In contrast, in 1997, only 22.3% would vote against a motion to demutualise.

5. Do you think that organisations with mutual status are worth preserving?

Q5 worth preserving?	Canterbury	Brighton	London
YES%	52	60	40
NO%	20	36	32

percentage of all interviews

On average 51.7% of those interviewed thought that mutuality was worth preserving and 29.3% of those interviewed thought it was not worth preserving.

6.Why do you think that mutual status is worth preserving?

Those in the Affirmative.

Q6 why preserve mutuality?	**Canterbury**	**Brighton**	**London**
traditional	8	0	4
competition	28	36	28
cheaper mortgages	40	36	40
democratic	12	24	16
personal service	20	24	8
good for small savers	24	32	20
total number in the affirmative	twentysix	thrity	twenty

percentage of all interviews

Q6 why preserve mutuality?	Canterbury	Brighton	London
traditional	15	0	10
competition	54	60	70
cheaper mortgages	76	60	100
democratic	24	46	40
personal service	38	46	20
good for small savers	46	62	50
total number in the affirmative	twentysix	thirty	twenty

percentage of group in favour of mutual societies

Mutuality is not worth preserving: Reasons

Q6 why end mutuality?	Canterbury	Brighton	London
slow & old fashioned	12	28	24
uncompetative	20	24	24
indifferent to organisational form	0	8	12
total number in the negative	ten	eighteen	sixteen

percentages of all interviews

Q6 why end mutuality?	Canterbury	Brighton	London
slow & old fashioned	60	78	75
uncompetative	100	67	75
indifferent to organisational form	0	22	38
total number in the negative	te1	eighteen	sixteen

percentage shown as a proportion of this category

Conclusion:

The second survey indicates a greater overall understanding of the organisational form of the mutual society. In addition to this, mutuality is increasingly viewed as a positive attribute of a business organization and one that is worth preserving. This indicates that the supporters of mutual building societies have been more successful in communicating the meaning and benefits of mutuality to the public at large and that previous conversions have had an educative effect. Problematically, however, this increased appreciation has not translated itself into an intention to vote against a motion to demutualise, should it arise, so long as the short- term financial benefits to members continue to be offered as part of the conversion package.

Chapter 7

New Labour: Mutuality v New Mutualism

1. Introduction: The 'Third Way' and New Labour: The Contemporary Context for Mutuality

2. Financial Exclusion: What it was and the role of the mutual society

3. The membership and mutuality

i. The Nationwide Building Society

ii. The Bradford and Bingley Building Society

4. Centralisation and The Financial Services and Markets Act 2000

5. Conclusion

Introduction: The 'Third Way' and New Labour: The Contemporary Context for Mutuality

The final context to date in which the concept of mutuality has found itself is within a set of policies dominated by the politics of New Labour, popularly described as the 'third way' or less commonly as 'concern, or stakeholder capitalism'. In this chapter it will be argued that the politics of New Labour is primarily committed to a market economy that necessarily extinguishes social institutions like the mutual society on the altar of market criteria. This point is amply demonstrated by an examination of the Financial Markets and Services Act 2000 and by New Labour's general unwillingness to take measures to protect mutuality. Conversely, New Labour's politics shy from the rhetoric of the free market, preferring instead the rhetoric of *inclusion* and *mutualism.* The latter tendency is likely to cause confusion in respect of the underlying pro- market orientation of the present administration and instill a belief that under a Labour government, mutual organizations are likely to be safe.

In order to understand the political perspective of New Labour, this chapter begins by outlining the thoughts of its *de facto* architects, the authors of the three most influential books on the subject, *oft* quoted and praised by the upper echelons of the government. These are, in descending importance, Anthony Gidden's, *The Third Way*, Will Hutton's *The State We're In* and Charles Leadbetter's, *Living On Thin Air.*

As the 'third way' politics of New Labour may be understood as the outcome of a reaction against old style socialism (a broad umbrella containing the 'far left' and the Labour Party of the 1970s) and the neoliberal politics of Thatcherism, its emergence may be described dialectically. As a dialectical process it can be viewed as the synthesis emerging from neo-liberalism, the anti-thesis of the thesis, socialism. It is perhaps then, a little ironic that the generally acknowledged architect of the political notion of 'the third way', Anthony Giddens, began his influential book, of the same name with a perfunctory debunking of Marxist thought, which, he argued, failed to appreciate the resilience and innovation of capitalism.[1]

Third Way politics, as articulated by Giddens, may be summarized as an attempt to connect the social welfare principles of socialism with a strong national market operating in a global context. Giddens constructed this model through a critique of socialism and neo-liberalism and concluded that whilst both schools of thought were flawed, modern society and the consciousness of the populace generally remained entrenched in certain elements of both. For example, he argued, the individualism of the 1980s had left a residual aversion to many of the activities of the welfare state. During this decade, in particular, the welfare state had been criticized by the right for being undemocratic and for suppressing personal liberty, criticisms that had a powerful appeal because they were, in part, true. Giddens himself described the welfare state as being 'bureaucratic, alienating and inefficient'.[2]

However, he notes, these tenacious notions of individualism have not led to a corresponding aversion to the making of welfare claims. Neither has it affected the population's moral affinity to the 'socialist' principle of providing for the vulnerable. At first blush, he rightly argued it might appear that these two perspectives, individualism and socialism, were incompatible. However, Third Way politics could encapsulate both perspectives and these two seemingly irreconcilable positions could co-habit in a world where increased individual liberty was coupled with increased individual responsibility; 'Having abandoned collectivism, third way politics looks for a new relationship between the individual and the community, a redefinition of rights and obligations'.[3]

Expanding individualism would mean expanding individual obligations. Thus, he argued, a consciousness must be nurtured which allowed for a responsible, mature individualism. So, in

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[1] Anthony Giddens (1998) "The Third Way" Polity Press
[2] ibid p113
[3] ibid p64

respect of the welfare state, 'third way politics sees these problems not as a signal to dismantle the welfare state, but as part of the reason to reconstruct it'.[4]

Third Way politics identified the role of the state, not in the minimalist style of the neo-liberal's Hayekian vision, nor in the intervention vision of the socialists. Instead, the role of the state was to promote the market whilst maintaining a more generalized prosperity through some limited government intervention in its activities.

> Classical social democracy thought of wealth creation as almost incidental to its basic concerns with economic security and redistribution. The neoliberals placed competition and the generating of wealth much more to the forefront. Third way politics also gives very strong emphasis to these qualities, which have an urgent importance given the nature of the global market place. They will not be developed, however, if individuals are abandoned to sink or swim in an economic whirlpool. Government has an essential role to play in investing in the human resources and infrastructure needed to develop an entrepreneurial culture.[5]

Third Way politics deployed a 'social investment state', which aimed to create a 'new mixed economy' that would comprise a, 'synergy between public and private sectors, utilizing the dynamism of markets but with the public interest in mind'.[6]

In third way politics, the balanced combination of public and private sectors was important for a number of reasons. An overly dominant market tended to perpetuate inequality, as evidenced by the great differentials in meritocratic societies such as the US, the UK and New Zealand. However, an overly public, welfare economy tended to create a 'dependency culture'. In third way politics, the key to moving toward greater equality in a modern society was the elimination of *social exclusion*. Third way politics viewed, 'equality as inclusion and inequality as exclusion'.[7]

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[4] ibid p113
[5] ibid p99
[6] ibid p100

> Inclusion refers in its broadest sense to citizenship, to the civil and political rights and obligations that all members of a society should have, not just formally, but as a reality of their lives. It also refers to opportunities and to involvement in public space. In a society where work remains central to self- esteem and standard of living, access to work is one main context of opportunity. Education is another, and would be so even if it weren't so important for the employment possibilities to which it is relevant.[8]

Social exclusion, argued Giddens, referred both to the experience of the poor and that of the very rich. The latter, of course, choose to be excluded, a situation known in sociological terms as 'the revolt of the elites', but both have a negative impact on society as a whole. This form of social exclusion occurs, argues Giddens, in a social world where the old class concepts have dissolved and where traditional methods of production, such as manufacturing, had been replaced by new methods, such as information technology. Rich and poor are increasingly polarized, but the concepts traditionally used by sociologists to understand this have become outmoded.

In order to counteract the many forms of social exclusion which perpetuated inequality, third way politics would construct an 'inclusive society', utlilising the ingredients of, 'equality as inclusion, limited meritocracy, renewal of public space (civic liberalism) beyond the work society, positive welfare and a social investment state'.[9] The trend toward a socially excluding society could be reversed through a ' civic liberalism' which encourages a political and economic commitment from the richer elements of society to the poorer. Furthermore, a private solution could be found to public welfare programs if the middle classes possessed a self-interest in maintaining the welfare state. This self-interest could be satisfied by improving the services offered by the welfare state, elevating welfare from a 'safety net' for the poor into a series of high quality services, which all classes could enjoy. Indeed, he argued, 'where, 'welfare' assumes only a negative connotation and it is targeted largely at the poor, as has tended to happen in the US, the results are divisive'.[10]

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[7] ibid p102
[8] ibid p103
[9] ibid p105
[10] ibid p108

Thus, third way politics seeks encourage the market economy, whilst ensuring that its tendency toward social division is tempered by some limited state intervention to encourage socially responsible and community sensitive commerce. In this way, third way politics accommodates aspirations for individual freedom by making that freedom dependent on a commitment to certain social obligations. In the context of the welfare state, the freedom of individuals to enjoy its benefits should be tempered by their obligation to pay for its continual improvement, and to limit personal claims to state benefits, education and healthcare by taking a more responsible attitude to work, childcare and healthy living. In the context of artificial legal individuals, such as the company, the individual freedom to operate in the market must be tempered with social obligations to communities and the environment.

The notion of the 'socially responsible business' was also discussed at length by another writer with the 'ear' of the Government, Will Hutton, former editor of the *Observer* newspaper. His version of third way politics was discussed under the concept of 'stakeholder capitalism' in his briefly important book, *The State We're In.*[11] In this treatise he argued for the encouragement of the socially responsible corporation in which the interests of all 'stakeholders' were negotiated. These 'stakeholders' would include, consumers, employees, creditors and local communities, as well as the well-established interests of shareholders. This approach would encourage a commitment from all those concerned with the corporation and would give them a reason to pursue the prosperity of the business, an outcome clearly popular with business owners. Hutton's more radical message, however, was that business should not be run purely for the purpose of creating profit. The interests of shareholder's dividend, was only one of the interests that business should ideally pursue. Shareholders were just one among many stakeholders and should take their place among a myriad of other priorities.

Hutton's socially responsive business held clear socialist undertones, yet in spite of this, 'stakeholder capitalism' remained a buzz phrase of New Labour for many years, although the

[11] Will Hutton (1996) "The State We're In." London. Jonathan Cape

policies were not pursued. The 'pluralist approach' to the company akin to stakeholding was abandoned at the end of the nineties in favour of 'enlightened shareholder value', an idea much more akin to third way politics. The latter notions have retained their popularity with the policies of New Labour together with the occasional ideological garnish such as that presented by Charles Leadbeater in his book, *Living on Thin Air: The New Economy.*[12]

Like Giddens, Leadbeater argued that the old class system had disappeared and, with it, traditional methods of retaining social order. However, unlike Giddens, Leadbetter attempts to understand this in terms of the material basis of social order. The economy, he argued, has shifted from industrial production to a 'knowledge based economy', but has done so whilst attempting to retain the institutions of social order that maintained and described the older economy. So, despite moving into a knowledge-based economy with all its potential democratic and safe connotations, individuals were experiencing their life as fraught with increasing anxiety. However, he argued, this sense of anxiety and powerlessness was not a personal failing but an institutional failing. Whilst the economy has undergone huge changes, the institutions that contained and sustained the economy had not. Indeed, the institutions that exist today were, in all their major characteristics, institutions designed to meet the needs of industrial Victorian England.

> The nineteenth century was revolutionary because the Victorians matched their scientific and technological innovations with radical institutional innovations: the extension of democracy, the creation of local government, the birth of modern savings and insurance schemes, the development of a professional civil service, the rise of trade unions and the emergence of the research based university. We live with the institutions the nineteenth century handed down to us. Our highly uneven capacity for innovation is the fundamental source of our unease. We are scientific and technological revolutionaries, but political and institutional conservatives.[13]

The 'new economy', which to a greater extent is viewed as developing naturally and organically, required new institutions to be artificially created through government policy. Thus, the market

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[12] Charles Leadbeater (1999) 'Living on Thin Air: The New Economy' (Viking Press.)

itself demands third way politics in order that it may continue to prosper. New Labour's attempt to reorganize welfare, work and social order is not so much autonomous political policy as a sensitive response to the requirements of the new 'knowledge based economy'. Little wonder then that Tony Blair is cited on the back cover as saying, 'Charles Leadbetter is an extraordinarily interesting thinker. His book raises critical questions for Britain's future. I know it will be widely read and debated'.[14]

The stated challenge of the New Labour government with their commitment to third way politics was to reconstruct a social order appropriate to the demands of a new economy. They would create this new social order through one single method, the eradication of social exclusion. Social exclusion, however, was a many-headed beast and the head that faced mutual building societies was that of 'financial exclusion'. Indeed, those business organizations that made money through dealing with financial products were charged with the specific duty of combating this form of social exclusion.

Financial exclusion: What it was and the role of the mutual society

The Building Societies Association's Annual Conference of 1999 invited the cabinet minister Stephen Timms to speak on Government policy in respect of mutuality and building societies. Mr Timms took the opportunity to discuss and define financial exclusion and to expand on the role of mutual societies in its eradication.

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[13] ibid preface
[14] ibid cover page

In his speech, Stephen Timms outlined the Government's vision of linking welfare reform and the financial services industry in measures to tackle financial exclusion. He argued that this connection presented a 'business opportunity and a challenge to the financial services industry'.[15] It represented, he contended, a rational response to the demands of the new economy of the 1990's, (an economy that differed from the industrial economy of the sixties and seventies and the service-based economy of the eighties). This new economy consisted of, 'strong, knowledge-based companies ready to take on the global economy by properly harnessing the know-how, the creativity, the expertise of all of our people'.[16] It would, therefore, depend upon, 'imaginative and effective partnerships with you (the building society industry) and others'.[17]

Welfare policy was, argued Mr Timms, geared toward dealing with the problem of increased spending on welfare coupled with a corresponding increase in social welfare problems. The knock-on effect of this combination, he argued, was the emergence of a culture of dependency where,

> One in five children live in a household where nobody works and over 2.3 million children live in a household dependent on income support.... and who know nothing other than benefit dependency as a way of getting by.[18]

Some children have, 'never known what it is for somebody at home to go to work every day, their mothers and fathers will have experienced the same and if we do nothing their children will be in the same position as well'.[19] These groups were, he stated, condemned to social exclusion and suffered from the greatest health problems and were the most likely to be the victims and perpetrators of crime.

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[15] Conference Speech. BSA Annual Conference 1999
[16] ibid
[17] ibid
[18] ibid
[19] ibid

Because of this social exclusion, the Government was appealing to financial organisations on the 'grounds of enlightened commercial self-interest'.[20] Building societies were, he argued, in a position to draw the financially excluded into its ambit, thereby profiting from an extended market of a potential 1.5 million households who lacked any financial products and a further 4.4 million who were on the margins of financial services provision.[21]

Drawing upon the Government paper, *Bringing Britain Together*, Mr Timms indicated how those excluded from mainstream financial products were likely to pay excessive amounts to receive any kind of financial product. For example, a simple loan made to somebody to whom banks would not lend would be likely to be subject to extortionate interest rates.[22]

> They can use licensed money lenders who can charge APRs of between 100% and 500% depending on the size and length of the loan, and for some people even that option isn't open because licensed lenders are reluctant to lend cash on a high crime estate, the alternative for that group will be unlicensed money lenders who can charge really extortionate rates of interest. One example cited in recent research where a pensioner couple who paid £250 interest on a £500 loan taken out for twenty weeks.[23]

Furthermore, he argued, the number of those excluded from quite basic financial facilities was quite high. Research sponsored by the British Bankers Association suggested there could be

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[20] ibid

[21] ibid As reported by the Joseph Roundtree Foundation

[22] Bringing Britain Together. The Association has responded to the consultation exercise organised by the Treasury Policy Action Team developing a strategy to increase access to financial services to people living in poor neighbourhoods. The Action Team reported to the Prime Minister in July

[23] The Report of pat 14 suggested that high crime areas will be serviced by money lenders but that their interest rates were likely to be even higher and they would seek security' for an advance such as a benefit book or a passport. P14

between 12% and 18% of households without a current account.[24] A large percentage of these were people of working age of whom 30% had accounts but closed them after becoming unemployed and a further 30% had never had one. This research showed that this group was predominantly poor with limited employment opportunities. A situation that was further constricted by having no bank account, since an estimated 80% of those in work were paid by A.C.T., those with no accounts were further alienated from the financial exchange process. Furthermore, those with bank accounts could enjoy cheaper methods of paying bills such as payment through Direct Debit. As cash became a more archaic method of exchange, those who had no banking facilities faced increased isolation.

The task required from building societies was to reduce this kind of financial exclusion by providing innovative ways to increase financial access whilst continuing to pursue the interests of existing society members. In Mr Timms' words,

> there must surely be mainstream commercial opportunities here. We do understand, in commercial terms, that widening access has its problems, providing comprehensive services with little prospect of a return is not on your agenda and neither should it be. But equally, in an increasingly cashless society, those who are 'unbanked' will have a growing need for banking services.[25]

As well as lacking banking facilties, poorer households were often excluded from house and life insurance policies. If these were taken out they tended to lapse, and in crime-ridden areas (which tended to be poor), home insurance policies were too expensive. Research by the Rowntree Trust showed that only one in five families in the low-income band possessed house insurance.

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[24] The figures depend on the researcher in question. Research published by the British Bankers Association (BBA) indicates that between 6 percent and 9 percent of individuals- about 2.5-3.5 million adults- have neither a current or a savings account, depending on the data source used: and estimates of the proportion of individuals without current accounts vary between 14.5 and 23 percent. Research undertaken by the Office of Fair Trading (OFT) found that in 14 percent of households, no one had a current account". P42 pat14

[25] op cit BSA speech

Finally, many people were excluded from an occupational pension because their working life was characterised by low and intermittent earnings. To counter this, the government proposed the introduction of 'Stakeholder Pensions', designed for those earning around £9,000 to £20,000 a year and who were likely to experience periods of unemployment. Mr Timms enjoined the BSA's delegates to provide support for such a scheme saying,

> your industry has a great story to tell in the contribution that it's made to ensuring that pensioners have shared in the growing prosperity of Britain. Help us now take this one step further by ensuring that all working people can access first class, top quality, second tier pension provision.[26]

He concluded by stating that building societies could play a part in the regeneration of poor areas by providing access to capital or just, 'advice and understanding'. Branch closures, though understandable in economic terms, tended to exacerbate the problem but, he suggested, building societies could continue to provide 'a local presence but with access to centrally provided expertise and facilities'.[27] In addition to this, he suggested that building societies could provide advice and support for the credit unions that were now best situated to provide services to the poorer areas. This could be the new role for, in Mr Timms' words, 'new mutualism'.

New mutualism, as described by New Labour representatives broadly describes a commercially sympathetic form of business that considers the interests of local communities. However, this version of mutuality does not see as its core the preservation of mutual status. Mutualism is an attitude rather than a specific form of organization and new mutualism does not depend on there being a mutual society.

However, as a series of interviews taken with the chief executives of the remaining mutual societies suggests, old style mutual organisation remains central to their understanding of their building society and, in many cases, is viewed as a direct route toward the incorporation of the

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[26] ibid
[27] ibid

socially excluded.[28] That is, building societies may attend to the socially and financially excluded if they can continue to operate as a mutual organization. Without this particular status, they argue, the interests of dividends and short- termism will prevail.

For example, Martin Armstrong, chief executive of Norwich and Peterborough Building Society stated that the essence of mutuality was the absence of external shareholders whose sole interest in the business was dividends. Because of this, as a mutual society,

> we can do things for our customers a PLC couldn't do. Primarily, keeping open branches in small communities in rural areas where their towns are dying and their communities are dying because major organisations are pulling out because they can't make enough profit. We need to make a profit at a branch to keep it in existence but it doesn't have to be the absolute maximization in terms of use of capital.[29]

Furthermore, a mutual organisation allowed customers who were also owners to have a direct effect on the running of the business.

> I think, my view is that the majority of our shareholders contribute very positively to us because they are our customers. They are loyal to us, they appreciate what we do for them, they tell us if we don't do it right and we try and put it right and our whole *raison d'etre* is customer service and we believe that what we're there for.[30]

In his view, this method of organisation brought in 'customer service' before such a concept had caught on in any other industry.

Likewise, Greg Williamson chief executive of the Shepton Building Society specifically drew the connection between mutuality and the protection of those who are, or who could be in danger of being financially excluded in the future.

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[28] Series of interviews with chief executives undertaken by the writer during the BSA Conference 1999. Questions asked set out in appendix 3.
[29] Ibid Martin Armstrong, chief executive of Norwich and Peterborough Building Society

> Mutuality means to me being able to look after our existing customers our existing communities, its not just about being able to offer the cheapest products or the most expensive shares. It's about looking our customers, after people that can't use the Internet, that can't get to the bank that need local branches.[31]

In Greg Williamson's view, modern banking methods were entirely unsuitable for small communities with an ageing demography. Branch banking and the individual services offered by mutual societies were the only suitable method for ensuring the inclusion of the local population.

Gorden Wells, chief executive of Melton Mowbray Society, likewise said that,

> Mutuality (to me) has always meant, basically, a membership based club, an organisation belonging to the members. In an organisation like the Melton, which is a small market town, the origination of the society has always been based on that tradition of belonging to the members of the community of Melton Mowbray district, and the society has continued in that vein without merger, based upon serving the community in the East Midlands, in which we operate. So, I see it very much as delivering to members financial services in the traditional building society mould.[32]

Roger Hollick, chief executive of the Derbyshire Building Society and one of the most experienced executives, having worked in mutual societies since 1963, including 23 years as chief executive of the Woolwich Building Society, also took the view that mutuality was a concept entirely bound up with 'social inclusion'. Furthermore, he argued, both the investing and non-investing public viewed building societies in this way.

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[30] ibid

[31] ibid Greg Williamson chief executive of the Shepton Building Society

[32] ibid Gorden Wells, chief executive of Melton Mowbray Society

> I do actually believe it is right that an organisation like ours is owned by the community and we've carried out research and we've said to non- customers, (say they've been customers of the Abbey National), 'how do you feel about the Derbyshire Building society being taken over'. And people have said to us, 'we wouldn't like that'. So the researcher says 'but you aren't even a customer', to which the reply is, 'ah, but it's our society'. So there's a relationship with something that carries the county name operating in the East Midlands.[33]

The chairman of the Holmesdale Building Society, Joe Parker and chief executive Ian Booth, both viewed mutuality in the context of their society as something that had a social benefit because theirs was,

> a small local society giving members good efficient service and understanding members needs.... not running business for profit but running a business for member's benefit.[34]

Ian Booth demonstrated that their building society acted directly to counter social exclusion by attempting to be sensitive to customer's problems and to respond to them in caring and responsible manner.

> People in trouble and everybody gets into trouble at some point in their life need consideration. We haven't evicted anyone in three years and that was done on agreement. Poor chap was in great trouble and we actually gave money back to him and arranged social housing for him at the same time because that's what a local society can do. We go and see them when they can't pay and we try to find a way to help them. And that is mutuality in practice which of course is extremely difficult for large societies.[35]

Furthermore,

> Being small and local, members talk to us. Members are our shareholders and that's the point. We work for them by giving them good rates and considerate

[33] ibid Roger Hollick, chief executive of the Derbyshire Building Society
[34] ibid Chairman of the Holmesdale Building Society, Joe Parker and Ian Booth
[35] ibid Ian Booth chief executive of the Holmesdale Building Society

> service, we don't work just to make a profit to send away and that's what you do with a PLC. You send the profit out and to those shareholders it's just a business and that is contrary to what we do as local society.[36]

Jon Macpherson, chief executive of the Ilkestone Permanent, described himself as passionate about the mutual system and considered its protection to be a political act. For him, mutuality designated,

> a business owned by members who own the mutual benefit of it, the benefits of saving for savers. It's run in the interest of those members who actually own the business.... mutuality is the purest form of ownership, I think that a demutualised organisation is a plc and it exists for no purpose other than to maximise profit. No plc exists for any other purpose, its only their marketing departments that tell you that they do. There is no other function in their life other than maximising their profit that is not the purpose of a building society. My society is not run to maximise profits, it's run to make sufficient profits for the security of our customers. My main driving force is to give the best service to customers and to balance the interest of the investor.[37]

Some delegates at the 1999 BSA conference were more circumspect in their assessment of mutuality. Although most agreed it was worth preserving, many considered it to be merely an effective method of organising ownership and profit sharing and did not draw the connection between mutuality and 'financial inclusion'. For example, Peter Philips, chairman of the Principality Building Society since 1991, stated that mutuality simply meant, 'an organisation that receives its funds from its members and does all its business with its members'.[38] Similarly, Peter Rowley, chief executive of the Darlington Building Society, argued that mutuality meant, 'common ownership, whereby the customers by virtue of their qualifying membership of the institution have a share in the ownership of it'.[39] Rob Cairnes, chief executive of the Furness Building Society thought that, 'mutuality is giving the best deal to the customer in terms of low

[36] ibid Chairman Joe Parker
[37] ibid Jon Macpherson, chief executive of the Ilkestone Permanent
[38] ibid Peter Philips, chairman of the Principality Building Society
[39] ibid Peter Rowley, chief executive of the Darlington Building Society

mortgage rates and high savings rates so that customers mutually benefit'.[40] And, David Roberts, chief executive of the Monmouthshire Building Society, saw mutuality as denoting a, 'business being run for the benefit of all the stakeholders and balancing the interests of all the stakeholders as equitably as you can'.[41]

Interestingly, the 'white knight' of mutuality, Brian Davis, then chairman of the Building Society Association and chief executive Nationwide Building Society saw the benefits of mutuality in purely commercial terms, saying,

> There are three benefits to mutuality one is clearly that there is a pricing benefit which you can translate in the high street. But I think it's much more than that because as a management team, we're much more focused on our customers since we don't have an external audience to worry about. And, thirdly, we operate as a competitive force in the high street we present another way of doing business and, in general terms, a nicer way of doing business.[42]

However, the mutual system in his view brought different attributes to business that were not necessarily superior attributes and that operating business as a PLC was not necessarily a bad thing.

> a mutual organisation has a different structure where, as it happens, it is the customers who're asking those questions and are pushing you and have to elect you and everything else. So, in many ways, you have a similar discipline to shareholders, it's just a different type of structure that has the advantage that it has one single audience. So the disadvantage, and I've worked for a PLC for sixteen years, and the disadvantage is that you have to have two ears. I mean that you have to be listening in two different directions. In some ways we have to be more focused and it's clearly easier. There's nothing wrong with a PLC anymore than a partnership or any other form of ownership, it's just different.[43]

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[40] ibid Rob Cairnes, chief executive of the Furness Building Society
[41] ibid David Roberts, chief executive of the Monmouthshire Building Society
[42] ibid Brian Davis, then chairman of the Building Society Association and chief executive Nationwide Building Society
[43] ibid

Likewise, John Herd chairman of the Dunfermline Building Society saw mutuality as a form that made good business sense for all 'stakeholders'.

> Mutuality probably benefits the whole, that is the borrowing members and the lending members who're often the same people and also the staff who are very important stakeholders as well. So we have three different constituencies all of whom benefit from the fact that over the years we have accumulated a very considerable fee capital which does not cost us any money. That allows us to price our products really competitively on both sides of the book.[44]

Similarly, Rory Matheson, chief executive of the Scottish Building Society for 14 years said of mutuality that,

> members own the business and the organisation works for the direct benefit of the members, there's not a third party unlike the plc model where you have outside shareholders as well as your direct customers. Its a simpler set up in that sense and I think its works well and has worked well for the last 150years, first formed in 1848, so its lasted that long.[45]

In contrast to this view, Nigel Baige, chief executive of the Chelsea Building Society, argued that although mutuality had existed for many decades it had undergone many historical developments. It was, however, something that was worth preserving,

> Mutuality has changed over the last 100 years, what it means really now is that a mutual is just different from a plc. The structure means that the major difference is that a building society doesn't have to pay dividends to shareholders whereas a plc does because the shareholders actually own the equity whereas in a building society the shareholders don't own the equity which gives building societies a

[44] ibid John Herd chairman of the Dunfermline Building Society
[45] ibid Rory Matheson, chief executive of the Scottish Building Society

> margin of advantage over a plc, that is the major difference and that really is the defining difference between a plc and a building society.[46]

David Cullum, Chief Executive of the Manchester Building Society thought that now many of the building society's organizational problems had been addressed that the mutual system had many advantages over the company form.

> Mutuality gives us one more advantage in running a business than companies because we don't have to pay dividends. I think mutuality has been used as an excuse for societies not being as efficient as they could have been in the past, if you go back ten or fifteen years when there was a cartel. Now the combination of mutuality and competition has meant that most of us are pretty efficient because we have the big advantage that we don't pay dividends.[47]

Dr Haydn Ward, chairman of the National Counties Building Society viewed mutuality as a method of constructing an organisation, 'where the customers of the building society are effectively also the owners and share in the benefits of ownership'.[48] Whilst David Hayward, chief executive of the Lambeth Building Society, saw mutuality as a method of balancing the interests of the various owners.

> Mutuality is treating all the customers as fairly as possible, relative to their relationship to the society. Yes, you'll never get it absolutely perfect when you balance the interests of borrowers to savers, new customers to old customers but what you've got to do is to try to treat everyone fairly and hopefully look after them all.[49]

On the other end of the opinion scale, John Goodfellow, chief executive of the Skipton Building Society, saw little added value in mutuality saying,

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[46] ibid Nigel Baige, chief executive of the Chelsea Building Society

[47] ibid David Cullum, Chief Executive of the Manchester Building Society

[48] ibid Dr Haydn Ward, chairman of the National Counties Building Society

[49] ibid David Hayward, chief executive of the Lambeth Building Society

> structurally, there isn't much difference (between a mutual society and a plc) apart from in mutuals it's one man, one vote, (a bit like the slogan of the Labour party) and plcs of course is one vote one share, you get bigger share voting blocks than you do in a mutual. But apart from that, there is little difference between them.[50]

Combining the two positions, John Beswarick, finance director of the Derbyshire Building Society, argued that mutuality worked in two ways. Firstly, it made commercial sense, and, secondly, it supported local communities as it gave,

> added value to both borrowers and investors by trying to take a balanced view between the conflicting demands of those two constituencies and also trying to take a longer view and, in particular, for regional societies and possibly local societies, adding particular value in supporting their communities.[51]

Finally, Kevin Hurst, chief executive of the Nottingham Imperial Building Society, pointed out that although mutuality was a positive concept, it was not unproblematic. For example, mutuality had a tendency to disempower those involved in the society that were not members, thus effectively empowering groups of members that had conflicting self-interests.

> Quite simply, there is no other stakeholder in the business other than those who buy its services. The difference between the mutuality that we have and the mutuality that exists in, say, an insurance company, is that we have two diametrically opposed groups of people. We have a group of customers on the liability side of the balance sheet who would cut their throats if they were asked by customers on the assets side of the balance sheets for a change in their rates. It is not like the co-op where you go and shop and partake in the profits of the institution you've just shopped at. It is a group of people who want one rate of interest and a group of people who want another and therefore the mutuality is merely expressed in the fact that no-one else partakes in that process in terms of taking the profit from it, other than the people that run that process and I happen to believe that we are just as important as the members because at the end of the

[50] ibid John Goodfellow, chief executive of the Skipton Building Society
[51] ibid John Beswarick. finance director of the Derbyshire Building Society

day I believe that if you said to your borrowers would you take a quarter of a percent increase in your rates so that I can pay more to my savers, they would tell me where to go. So, I would say in that dichotomy then, I interpret my mutuality in that the customers have to be satisfied with the price and service basis, but I also have a group of people that organise this and have to be looked after just as much.[52]

The range of perspectives expressed by the chief executives of mutual societies were, in the main, indicative of the size of society in question. That is, a larger society such as the Nationwide has tended to couch its defense of mutuality in the language of commercial self-interest. Its members are perhaps less inclined to view themselves as a community connected to other members and are, instead, seeking a 'good deal' as individuals. In contrast, smaller societies such as the Ilkestone or the Shepton are more inclined to associate a defense of mutuality with community and locality, rather than commercialism. In other words, a society's defense of its mutual status will play to its long suit.

Whilst the strategies may differ, societies clearly agreed that the introduction of shareholders into the equation would have a negative impact on their ability to engage in any other activity than the production of dividends. Community concerns and methods of promoting financial inclusion could not develop in the context of shareholders interests. Thus, central to addressing the problem of financial exclusion lies the maintenance of a mutual organization. It is perhaps ironic then, that the very threat of demutualisation has lead many building societies to resort to strategies that exclude many people from membership, thereby financially excluding them. For example, in order to arrest the tide of carpet-baggers from becoming investing members on the basis of a fairly small deposit, some building societies have introduced a high minimum deposit that effectively excludes genuine new members that have a low income. Whilst such measures might deter casual carpet-bagging it also deters poorer potential members. In the words of Andrew Messenger, Chief Executive of the West Bromwich Building Society,

[52] Kevin Hurst, chief executive of the Nottingham Imperial Building Society

> You ask for help of Building Societies so that we can help you to help the financially excluded. Building Societies were formed for that very reason and in our case over one hundred and fifty years ago, and our founding principles were to help the local poor to better themselves through home ownership. We also do a great deal in the communities, spending over a half a million pounds each year all aimed at young people, helping them to better themselves. And yet all of this is under threat because of the carpet- baggers. I'll give you a good example from our own experience. We have had to re-increase the minimum balance to £5,000 because of carpet bagging, that means that we cannot provide an ISA, we cannot help the financially excluded.[53]

Other anti-carpet-bagging strategies have been specifically excluded by Government policy. For example, a number of societies offered low deposit accounts with no voting rights, so that new members seeking a motion and vote in favour of conversion would be thwarted. However, the 1997 Building Societies Act, 'ruled this out'.[54] The same report stated that, 'the building societies want the Government to introduce further legislation, to deal with the underlying pressure for them to convert in other ways. In the meantime, people seeking to open small savings accounts have fewer options than previously'.[55] However, this report did not itself recommend any measures to thwart carpet-bagging, instead it stated that building societies and banks should offer more basic low start up accounts ignoring the fundamental problems for a mutual society that partakes in such an activity.

In a similar vein, Government policy has tended to minimalise issues that building societies have viewed as central to mutuality, that of branch closures. Building societies have fairly consistently argued that conversion leads to branch closures, which in turn has a detrimental effect on local communities so, the Building Society Association funded research into the connection between conversion and branch closure which concluded that,

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[53] Andrew Messenger, Chief Executive of the West Bromwich Building Society in question to Stephen Timms BSA Conference 1999

[54] p50 Access to financial Services, Report of Pat 14 HM Treasury November 1999, National Strategy For Neighbourhood Renewal

building societies were more likely than banks to maintain their branch network. Societies were less likely than banks or convertors to close braches in more socially deprived location. In contrast, banks and building societies that have converted to plc status were more aggressive in closing branches. Convertors were most likely to close branches in deprived communities and least likely to open branches in such places.[56]

In specific figures, over the period between 1995-98, societies that had converted closed 11.4% of their branches, 282 in all, whereas the remaining mutual societies closed 8.9% or 224 branches. Yet, however significant the BSA felt this analysis to be, the Government policy has been to minimize it. The Government Report on financial exclusion, whilst acknowledging the fact that a number of organisations considered closures to be highly important, did not agree that closures had a significant effect on financial exclusion.

On the first point it said,

> shrinkage of bank and building society branch networks, especially withdrawal from low income areas, has often been blamed for contributing to financial exclusion. The Banking Insurance and Finance Union (BIFU), the Campaign for Community Banking and the Citizen Organising Foundation all emphasized this factor in their responses to the public consultation exercise. The Commission for Racial Equality pointed out that ethnic minority communities are frequently among those whose location in relatively deprived areas limits access.[57]

Yet on the second point it said,

> The relationship between branch closures and financial exclusion is far from straightforward. Following many years of expansion, the total number of bank and building society branches peaked out in the 1980 and has been declining ever since as institutions sought to contain their administrative costs. BBA figures

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[55] ibid p50-51

[56] JN Marshall, R Willis, S Raybould, R Richardson M Coombes "The Contribution of British Building Societies to Financial Inclusion" p2- Centre for Urban and Regional Development Studies- published on BSA Website

[57] Access to financial Services, Report of Pat 14 HM Treasury November 1999, National Strategy For Neighbourhood Renewal P47 para4.22

> show that, taking major British banking groups and building societies together, about one in four branches went between 1988 and 1998. But the proportion of adults with any kind of account grew from 90%-94% over the same period.(APACS Year book of Payment statistics 1999) This was a slower growth rate than in previous decades; but judging by the figures for current account ownership published by the OFT, the increase was particularly significant for people in social classes D and E. Research into why people do not have bank accounts indicates that only a tiny percentage say it is because of the lack of a nearby bank branch: the BBA suggests under 1 per cent of those without a current account.[58]

The report felt that closures were somewhat mediated by use of ATMs (only 46% of adults used these in 1990 compared to 68% in 1998). Furthermore, the remaining branches were located near popular working areas and train stations so they were highly utilized and customers also took advantage of telephone banking.

Paradoxically, while maintaining a network of local building society branches is not viewed as important in the delivery of financial inclusion, New Labour has been keen to stress the importance of local *Post Office* branches in doing so. In a meeting titled, "*Banks and post offices-delivering financial inclusion?*" at the Labour Party Conference 2000, delegates and speakers agreed on the importance of local branches in the delivery of financial inclusion. However, the branches in question here were the 18,000 post office outlets upon whose continued preservation the delegates congratulated themselves.[59]

Speaking first, Ed Sweeny from the UNIFI, stated,

> Over recent years there has been a huge increase in branch closure which has had a degenerative affect on the local economy, with shops and businesses closing or relocating, as well as stopping people being able to access banking services. There are huge social costs of no community banking". Indeed, far from other forms of

[58] ibid Para 4.23

[59] Labour Party Conference "*Banks and post offices- delivering financial inclusion?*" Wed 27 September with UNIFI/CWU

banking picking up the slack, "on- line banking had not been picked up by smaller customers.[60]

Furthermore, he contended, in contrast to the fate of these local communities, banks had been making huge profits. From 1987-99 the profits from the banking sector were, 25% higher than all of British industry combined. Therefore, although hitherto banks had been unnecessarily dismissive of 'community banking' and similar schemes and had failed to promote their basic bank accounts, they should now be forcibly persuaded to support the universal banking system proposed by the Labour Party.

Likewise, Marlene Winfield (Head of Policy and Strategy, National Consumer Council), argued that banks were unnecessarily profitable, and furthermore, they were seeking to rid themselves of their poorer, less profitable customers, arguing that only a small proportion of customers were profitable. This, she argued, would exacerbate the problem of financial exclusion, as already 14% of the population was without a current account. In order to counter this, she stated, banks would need to be coerced into taking a more socially responsible attitude to their customers. This could be achieved through pressure from the banks' larger institutional shareholders such as pension funds, who were in any case required to report on their ethical investment policy. The Post Office, with one of the largest pension funds, would seem well placed to exert some pressure on banks to engage in the joint project of 'Universal Banking'.

The combination of the Post Office and banks working together would combine the reassuring environment of the former with the facilities and experience of the latter. It would help rehabilitate the 'greedy' image of banks by making them look like, 'good corporate citizens'.[61] However, banks needed financial incentives, which, the chairman of the meeting stated that the Treasury would not provide, 'the Treasury is not keen to fund this project and prefers the banks to fund'.[62]

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[60] ibid
[61] Marlene Winfield (Head of Policy and Strategy, National Consumer Council)
[62] ibid

Thus, the speakers concluded, financial exclusion needed to be tackled by having more local branches, possessed of a less corporate and therefore less intimidating image than ordinary banks. In addition to this, these outlets needed to have an organisational structure and personnel experienced in providing financial services. While the speakers wanted this to be provided by a hybrid of the post office and the bank, what they were describing already existed in the form of a mutual building society.

Yet, ironically, it has been government policy under both the Labour and the Conservative Party to close 'wasteful' building society branches. The old Labour government set up a Commission which recommended more branch closures, while its members argued in Parliamentary debates in the 1970s against the large quantity of high street branches.[63] After that, the Conservative government passed legislation that would make societies, 'market efficient' and more like banks, reflecting an era dominated by free market rhetoric. And finally, in the 'third way' era this legislation has remained intact and New Labour seem unwilling to protect societies from carpet-bagging, the unforeseen consequence of the freedom to demutualise.

Perversely, when the writer put to the panel of speakers that 'old' Labour's policy on building society branch closure seemed to run contrary to the present policy on financial inclusion, the chairmen denied that the party had ever possessed such policies. When it was put to the panel that there are dozens of references to branch closures recorded in Hansard, often by the MP for Ipswich, Ken Weetch, the chair replied,

> Ken Weetch was a back bencher and not representative of the Labour Party…..building society branch closures were contrary to Labour Party policy. The old building society account holders are not the individuals that fall under the social exclusion criteria, it is not relevant to preserve this form of banking.[64]

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[63] see chapter 4

[64] Chair of meeting

New Labour's concept of 'New Mutualism' seems to be rich in rhetoric and short of substance. New mutualism is a concept that sidesteps the legal concept and definite method of organization that is mutuality, whilst claiming for itself the moral and social connotations of a mutual society. Thus far, the evidence would suggest that whilst New Labour is aligned to the notion of new mutualism it seems unwilling to connect this concept to mutuality in the context of building societies and has shown little commitment to the protection of societies from the threat of demutualisation.

Governmental politics are one of the primary factors in the construction of mutuality. Another vital factor is the views of the members of mutual building societies: how far are they committed to retaining mutuality in the 'New Labour' era? It is this issue that this chapter will now address.

The Membership and Mutuality

As the empirical evidence suggests, the membership of mutual building societies have, following the mass demutualisations in 1997, become much more aware of the meaning of mutuality and, to a certain degree, have come to view mutuality as a positive attribute in a financial institution. Likewise, management in building societies have become more inclined to articulate the attractions of mutuality and of the reasons why such a legal construct is worth preserving. However, this commitment is most tangibly demonstrated by the actions of members and management when a motion for demutualisation arises. Yet within the membership and management of building societies evidence suggests a diversity of attitudes. This is vividly demonstrated by the oft proposed and as yet unsuccessful conversion campaigns centered around the Nationwide Building Society and the successful conversion of the Bradford and Bingley Building Society in 1999. It is to these two examples that this discussion will now turn.

The Nationwide Building Society: The Mutual of Mutuals

The Nationwide Building Society was the primary target of arch carpet-bagger, 'that butler' Michael Hardern. However, the society proved to be his nemesis as it has consistently repelled attempts to initiate a conversion and possessed a board of directors so committed to mutual status that the erstwhile butler himself was finally persuaded that mutuality was a quality worth saving in a building society. His campaign to demutualise the Nationwide was only narrowly defeated in 1997, but it was defeated in the year when most of the major conversions were aefected and when financial pundits were putting the value of 'free shares' at around £2,000. Commentators argued that the vote in favour of the five official and pro-mutuality candidates captured the spirit of an age that had just given a landslide victory to New Labour in the 1997 election.

> The swing of sentiment mirrors that which swept the Labour party to power earlier this year. The collective values still espoused by Labour, albeit in a watered down form, are reflected in the ideal of mutuality, in which customers rather than shareholders benefit from the organisation's surplus.[65]

Subsequent attempts by carpet-baggers to gain a vote in favour of conversion have been even more decisively in favour of mutuality. Michael Harden's campaigns were succeeded by the campaigns of another pro-conversion society member, Andrew Muir, who, after standing unsuccessfully for a place on the board of the Nationwide in 1998, returned to mount another even less successful campaign at the 2001 Annual Meeting. Commenting on the outcome of the directorial ballot, the BSA issued this press release,

> The members of Nationwide have made it quite clear that they see the vast benefits of keeping the society mutual, run by mutual directors. Andy Muir, who argued in favour of converting Nationwide to a plc, received around 400,000 votes fewer than when he stood for the board in 1998. All the existing directors, who also stood for election in 1998, have seen increase in their votes. There is

[65] FT July 24 "Mutuality respect beats get-rich ethic" Jonathan Guthrie

> clear evidence of Nationwide members appreciating the benefits that their society has brought to them.[66]

The continued preservation of mutual status in the Nationwide chiefly arises from the commitment of its management who inspired the membership to take the campaign personally. Its chief executive until 2000, Brian Davis, was a leading spokesperson for the benefits of mutuality and embraced the media to espouse a vigorous defense of mutuality. Furthermore, the management organized positively to preserve mutuality. One of its most significant methods was the establishment of the 'Nationwide Foundation' in November 1997. This charity, funded by profits from the Nationwide Building Society, stated its preferred areas of support as being for 'volunteer programmes' and 'rural regeneration'. However, the subtext of this charity was the way that it was organized, for all those who wished to open an account in the Nationwide Building Society could not opt out of membership of the foundation and members of the foundation were deemed to have 'agreed' to assign to the foundation, 'any future conversion payments'.[67] This has applied since the foundation was established. Thus, whilst new members accounting for over 2 million votes, may vote in favour of conversion, they will not personally benefit from any windfall payments.[68]

However, while this strategy may have hitherto contributed to the pro-mutual campaign there is a danger that the Nationwide may still be 'hoist by its own petard'. For, having made the moral argument for mutuality and connected it to social considerations, it might seem logical for the socially conscious member to vote in favour of conversion in order that the charity may receive the windfall payments! Society member Andy Naughton –Doe mounted a pro-conversion campaign which involved attempting to become a director of the Nationwide Foundation in order to persuade new members to vote for conversion *in order to fund the charity*. When the Foundation refused to let him stand for election he said, 'the trustees have missed out on an

[66] Press Release Adrian Coles 18 July 2001 BSA website

[67] Information from The Nationwide Foundation website

[68] number of new members as of 2001

amazing opportunity to receive a £1billion windfall. They are clutching at straws to find a way to bar members having this opportunity to vote for somebody with an alternative view'.[69]

The members of Nationwide Building Society will vote on a pro- conversion motion in July 2002, but, at the time of completing this thesis, the outcome was unknown. However, what is clear from the failures of the many campaigns to effect the society's conversion is that the combination of pro-active and pro-mutuality management and the conscious support of its membership ensured the preservation of mutuality. The next example discussed, the demutualisation of the Bradford & Bingley Building Society indicates that a failure to take affirmative action will enhance a tendency to conversion. And, if mutuality is indeed the 'pristine maiden' suggested by Austin Mitchell MP then the action or inaction of the Bradford and Bingley's board is a bad case of 'faint heart never won fair lady'.

Bradford & Bingley: The Mutual Conversion.

The directors of the Bradford and Bingley, as loyal advocates of the preservation of mutuality, astonished many by their almost overnight conversion to the benefits of a public limited status. In the words of Kevin Hurst of the Nottingham Imperial Building Society, 'this was a surprise and huge disappointment to many of us in the business. There seems to no justification for it in terms of membership demands or in terms of benefits to the society. It says a lot that Mr Rodrigous is not present at the conference today'.[70]

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[69] Quoted in the Sunday Express April 28 2002
[70] Kevin Hurst of the Nottingham Imperial Building Society at the BSA Conference 1999

The management of the Bradford & Bingley had hitherto mounted a vocal and practical defense of mutuality, albeit less vigorous than that of the Nationwide. Following the shedding of mutual status by the Cheltenham & Gloucester back in 1994, the then chief executive, John Wriggleworth, expressed concern that societies were failing to make a convincing an argument in favour of mutuality, 'our members would vote for conversion for two quid. We have to show them the benefits of mutuality'.[71] Therefore, in an immediate response to news of the huge bonuses paid to some members of the C&G, the Bradford and Bingley announced a mortgage rate cut of 0.25% and stated its intentions to, 'give back profits of at least £50m a year to savers and borrowers'.[72] This response was perhaps too little and too late, despite the constant warnings by the BSA to make very tangible the benefits of mutuality to their members. For example, in May 1994, the Financial Times reported that,

> Building Societies were yesterday encouraged by their regulator to use their surpluses to give dividends, better services and better prices to their members. Ms Rosalind Gilmore, who chairs the Building Society commission, said that with the housing market recovering and provisions for bad and doubtful debts falling, she could see no reason why societies should not narrow their margins and reward members in other ways.[73]

Later, management support for mutuality dwindled and, by April 1999, the board of the Bradford & Bingley announced its intention to put a vote for conversion to its members. The directors claimed to have changed their minds about conversion after 62% of voting members at an informal vote said they wanted their society to become a bank. This transition in thinking was a seemingly simple process. In the words of Christopher Rodrigues, group chief executive, 'as a mutual, we gave benefits through better rates. As a plc, we will give benefits through greater product choice and dividends to shareholders'.[74]

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[71] FT 25 Jan 1996 Bradford & Bingley cuts mortgage rate to 7.24% Roger Taylor
[72] ibid
[73] FT Allyson Smith 20 May 1994 Societies Urged to Pay dividends
[74] Jun 3 2000 Money Go Round: Bradford members weigh up windfalls: Nona Montagu- Smith Daily Telegraph

Initially, the directors portrayed themselves as the neutral arbiters of member's wishes, (a stance which delegates of the 1999 conference considered to be duplicitous in the extreme). Later, however, they embarked on a number of strategies that seemed to suggest a very pro- conversion stance. In October of 1999, the Bradford & Bingley announced plans to cut or move 385 jobs, which included closing two branches in Leamington Spa that employed 275 staff. *Save Our Building Societies*, (SOBS) the pro mutuality pressure group, said the move was driven by the conversion process, 'it indicates an attempt by Bradford and Bingley to slim down in preparation for the attempt to convert to PLC status next year'.[75] The society denied this saying it was trying to 'cut costs in the face of continuing competition'.[76]

In addition to this, in the following month the directors announced that members of the building society would all benefit from free shares as 'equals'. That is, all of its three million members, including those who had recently joined would receive a windfall estimated at around £1000. Critics argued that the board of the Bradford & Bingley had,

> arranged a flat windfall to encourage as many members as possible to vote for conversion, as carpetbaggers with a minimum £100 balance now have a huge incentive. Under some previous building society conversions, pay-outs varied according to how long people had been members and the size of their accounts.[77]

Again, chief executive Christopher Rodrigues justified the scheme as impartial, 'the flat scheme is the fairest. It gives the greatest number of shares to the greatest number of people'.[78]

The pro-mutual campaign group (SOBS) sought to stop the vote in favour of demutualisation by putting motions forward to that effect in the following AGM. A number of populist papers took a partisan position in favour of mutuality. For example the *Mirror* declared, 'if you're a voting

[75] 8 Oct 1999 Companies and Finance: UK: Bradford and Bingley staff move James Mackintosh
[76] ibid
[77] 17 Nov 1999 City: B&B goes for equality in windfalls: The Daily Telegraph Simon English
[78] ibid

member- membership lists are now closed- do yourself a favour and veto the conversion plan next year, especially if you have a mortgage with another provider'.[79]

However, SOBS failed to get the 500 signatures necessary to put forward their 7 resolutions against the conversion at the AGM and the following statement was made by a Bradford & Bingley spokesperson. 'We informed SOBS today that it had not gathered the necessary 500 signatures to put forward any resolutions to the society's AGM. Following out members' vote in favour of conversion we are now backing the conversion route ourselves and we believe this summer's vote will be more heavily in favour of conversion'.[80]

However, the previous informal ballot was passed only in respect of investing members and it was widely expected that borrowing members would vote against conversion, as over 60% had voted against the motion.[81] Furthermore, by the year 2000, the society's borrowing rate looked set to continue with its series of rises, reversing the previous agenda outlined earlier of John Wrigglesworth. The board appeared to be aligning itself with the numerically greater and more recently acquired investor members. As Christopher Rodrigues put it, 'the reason for our rate changes was simple: we need to be able to pay dividend to our shareholders and invest for the future. We intend to stay competitive as a plc'.[82]

The view that conversion would be rejected by borrowing members was underpinned by stock market news of falling share prices in the largest converted building societies such as the Abbey National, Halifax, Northern Rock and the Woolwich and, in general, the pro-mutuality lobby was very confident. For example, the *Sunday Herald*, reporting on the BSA Conference of 1999 said,

[79] 1 Dec 1999 Y2 keep loyal To Our Mutual Friends: Their Survival Benefits Us All: Daily Mirror John Husband

[80] . 4 Jan 2000 Money: Pro-Mutual Lobby Group Fails to Get 500 Signatures: Press Association Mark Atherton

[81] April 1999, although as noted the total number of voting members were in favour of conversion (BSA Newsletter May 1999)

[82] Mr Rodrigues: (Jun 3 2000 Money Go Round: Bradford members weigh up windfalls: Nona Montagu-Smith Daily Telegraph

‘the mood of the conference was more buoyant than for some time, several societies have successfully dispelled raiders, the truth is that carpet-baggers are no longer the major threat. Societies have learnt the hard way how to deal with them’.[83]

However, in the event, the motion in favour of conversion was overwhelming. With a high turnout, (70% of savers and 53.5% of borrowers), 94.5% of savers (1,505,000 votes) and 89.5% of borrowers (20,000 votes) voted in favour. Chairman of the Society, Lindsay Mackinlay said of the vote,

> The Board is delighted that so many members participated in this important and historic vote which clears the way for Bradford and Bingley to an independent plc. Based on this clear mandate we can now proceed to float on the stock market we are on course to complete the flotation in December.[84]

[83] 11 Jun 2000 Small Change: Sunday Herald Teresa Hunter
[84] statistics and quote from website http:// production.investis.com

Bradford & Bingley: Mergers

Bexhill on Sea BS 29 November 1993

Leamington Spa BS 1 July 1991

Hampshire BS 17 June 1991

Hendon BS 18 March 1991

Louth Mapleworth & Sutton BS 26 November 1990

Sheffield BS 15 June 1990

Chilterns BS 5 October 1987

Stanley BS 3 February 1986

Forresters BS 1985

H..ernian BS 1985

Merseyside Bs 1985

Clapham Permanent BS 1984

Dover & Folkestone BS 1984

Glamorgan BS 1984

Horsham 1983

Housing and General 1983

Padiham BS 1983

Stockport Mersey BS 1983

United Provinces 1983

Hearts of Oak & Enfield 1982

Saddleworth BS 1982

Swansea BS 1982

Target BS 1982

Hyde BS 1981

Centralisation and the Financial Services and Markets Act 2000

Through its many historical developments, mutuality has remained an organizationally distinct business form. The new mutualism outlined by New Labour is essentially a mission statement that could be adopted by any form of business and, as such, sidesteps the necessity to preserve the distinct nature of mutuality. In this final section we will examine another aspect of New Labour's tendency to diminish the uniqueness of a mutual building society, this time in the arena of regulation. This has been achieved through the passage of the Financial Services and Markets Act 2000, which has, in effect, introduced a single system of regulations and regulator for both mutual and converted building societies.

The overall purpose of the Financial Services and Markets Act 2000 (FSMA 2000) was to create a single system of regulation of financial services to be performed by one single regulator, the Financial Services Authority (FSA). Prior to the implementation of the provisions of the Financial Services and Markets Act 2000, the systems of vetting and registration fell broadly into two categories: those operated by the Self Regulatory Organisations ('SRO's) (1. Securities and Futures Authority, The Investment Management Regulatory Organisation and the Personal Investment Authority) and those operated by the statutory regulators for banking insurance and building and friendly societies. In general, the SROs applied vetting and registration procedures to senior management and to individuals dealing with consumers or their assets.

The first financial institutions to be regulated by the FSA were banks when the passage of the Banking Act 1998 transferred the regulation of banking from the Bank of England to the FSA. Two years later the FSMA 2000 transferred the regulation of building societies to the FSA and away from the Registrar of Building Societies. The two Acts now mean that the FSA is responsible for the regulation of investment business, friendly societies, credit unions, insurance companies and the Lloyds insurance market. And so, when the Act came into force in November 2001, it abolished the Building Societies Commission, the Friendly Societies Commission and the

Registry of Friendly Societies, together with other regulators such as the Insurance Directorate of the Treasury and the self-regulating organisations the PIA, IMRA and the SFA.

The change in regulator has also initiated a change in the *criteria* used to regulate. Prior to the FSMA 2000, the statutory regulators applied notification and vetting requirements to senior management and to certain specified positions. These positions were defined in terms of job title or reporting lines and in the main individuals did not require approval from the regulator before taking up positions. There was no provision for disciplinary action, although an individual could be found not 'fit and proper' and, therefore prohibited from continuing in the post.

The implementation of FSMA 2000 has initiated a shift in this aspect of the regulatory process with the introduction of what is known as the 'authorised persons regime'. This regime puts senior management of firms at the forefront in ensuring that effective governance structures are operated, and that they are accountable for their actions, a principle reinforced by section 2(3)(b) of the FSMA, which states that in discharging its general functions the FSA must have regard to the responsibilities of those who manage the affairs of 'authorised persons'.

The Authorised Persons Regime

Briefly stated, the FSMA 2000, insists that authorised persons have ensured that those that act on its behalf in respect of 'regulated activities' have met the objective standards set out in the legislation and supporting documentation. Those individuals are then deemed to be 'approved persons' and it remains an ongoing compliance responsibility of the authorised person to ensure that the approved person continues to meet those standards.

An authorised person is defined under s31(2) of the Act as, 'a person who is authorised for the purposes of this act'. That is, a person who has 'permission to carry on one or more regulated activities'.[85]

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[85] FSMA 2000 s.31(1)(a)

A person may apply for permission from the Financial Services Authority to carry on regulated activities if they are, 'an individual, a body corporate, a partnership or an unincorporated association'.[86]

The legislative base for the 'Approved Persons' regime is to be found in Part V of the FSMA 2000 in particular section 59(1) which provides that:

> An authorised person ("A") must take reasonable care to ensure that no person performs a controlled function under an arrangement entered into by A in relation to the carrying on by A of a regulated activity, unless the Authority approves the performance by that person of the controlled function to which the arrangement relates.

The operation of section 59(1) revolves around an individual performing what is described as a controlled function. A controlled function is defined by section 59(3) of the FSMA 2000, as 'a function of a description specified in the rules', which is supplemented by section 59(4) which provides that:

> The Authority may specify a description of function under subsection (3) only if, in relation to the carrying on of a regulated activity by an authorised person, it is satisfied that the first, second, or third condition is met.

These conditions are described in subsection (5), (6) and (7) respectively of the FSMA 2000. The first condition is that the function is likely to enable the person responsible for its performance to exercise a significant influence on the conduct of the authorised person's affairs, so far as relating to the regulated activity. The second condition is that the function will involve the person performing it in dealing with the customers of the authorised person in a manner substantially

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[86] FSMA 2000 Section 40(1)

connected with the carrying on of the regulated activity. The third condition is that the function will involve the person performing it in dealing with property of customers of the authorised person in a manner substantially connected with the carrying on of the regulated activity.[87]

Under this regime it is the kind of controlled function in which an individual is engaged that determines the level of care to be exercised by the approved person. This cuts across all kinds of organizations and does not, therefore, distinguish a mutual society from any other form of organisation. It is the type of controlled function alone that determines the level of care required.[88] The significant influence functions are subdivided into four functions, namely the governing functions, the required functions, the systems and control functions, and the significant management functions. Whether a function is likely to result in the person responsible for its performance exercising significant influence on the conduct of the firm's affairs is a question of fact in each case. This means that the management of all organizations dealing with financial products are obliged to conform to the same criteria relating to the scope of their duty to the organization whether they are a building society or a bank, effectively flattening the differentials in the management of mutual building societies and converted societies.[89]

[87] A customer is defined in section 59(11) as a, "a person who is using, or who is or maybe contemplating using, any of the services provided by the authorised person."

[88] The FSA provides practical guidance on controlled functions, in particular Chapter 10 of the Supervision Manual

88 The governing functions include the Director Function, the chief executive function, the partner function, the Directors of an Unincorporated Association Function, the Small Friendly Society Function and the Sole Trader Function. 'Required Functions', include the Apportionment and Oversight Function, the EEA Investment Business Oversight Function, the Compliance Oversight Function, the Money Laundering Reporting Function and the Appointed Actuary Function.
The Systems and Controls Function includes the Finance Function, the Risk Assessment Function and the Internal Audit Function. The Significant Management Function includes, Designated Investment Business Function, Other Business Operations Function, Insurance Underwriting Function, Financial Resources Function and Settlements Function.
Finally, the Customer Functions include, the Investment Adviser Function, the Investment Adviser (Trainee) Function, the Corporate Finance Adviser Function, the Pension Transfer Specialist Function, Adviser on Syndicate Participation at Lloyds Function, the Customer Trading Function and the Investment Management Function. If an individual performs a function

It should also be noted that the regulatory powers of the FSA are extensive and that it possesses the statutory teeth to ensure compliance. The FSA will grant an application under section 60 only if it satisfied that the person in respect of whom the application is made (" the candidate") is a fit and proper person to perform the function to which the application relates.[90] In addition to assessing fitness and propriety, the FSA possess powers to ensure ongoing compliance with these criteria and may withdraw an approval given under section 59 if it considers that the person in respect of whom it was given is not a fit and proper person to perform the function to which the approval relates.[91] A further and greater sanction is that of a *prohibition order*, prohibiting the individual from performing a specified function, or all functions, if it appears to the FSA that an individual is not a fit and proper person to perform functions in relation to a regulated activity carried on by an authorised person.[92]

An approved person is guided in his conduct by seven principles issued by the FSA. The first four principles apply to all individuals registered under the regime. The last three only apply to senior managers.[93] The rationale behind the Statement of Principles and the Code of Practice is the production of homogenized standards of conduct for those dealing with financial services. Central to this method of regulation is the ability to hold identifiable individuals accountable for failing to meet appropriate standards of prudent and sensible management and compliance with the firm's internal control and compliance procedures.[94] Crucially, it regulates on the basis of individual responsibility rather than the type of organisation to which that individual belongs.

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which does not fall under those headings, his firm need not seek the approval of the FSA on the question of whether he is fit and proper under section 59 of the FSMA 2000

[90] Section 61(1) FSMA 2000
[91] Section 63(1) FSMA 2000
[92] Section 56(1) FSMA 2000
[93] (APPENDIX 1) supplemented by a Code of Practice to determine compliance
[94] FSA Policy Statement:High Level Standards for Firms and Individuals June 2000

Chapter 8
Conclusions

It is the stated contention of this thesis that the demutualisation of building societies may be understood as resulting from the process of reconceptualisation that mutuality has undergone throughout its history. The reconceptualisation of mutuality has taken the concept of mutuality from one that originally denoted equality in relationships between members of an unincorporated association to one that merely described a method of organizing finance in an incorporated entity. In order to examine the validity of this hypothesis, this thesis adopted the Marxist method of dialectical materialism. This method was adopted as it allowed for the contextual examination of mutuality as a simple concept within a dynamic and changing historical period, from 1767 to 2002. Dialectical materialism, based on an analysis of the whole within which the simple concept exists, allows the researcher to avoid deterministic conclusions. It does this by assessing the (often conflicting) relationships between the simple features of the whole and the manner in which this creates the whole. Dialectical materialism appreciates the ongoing nature of these conflicts and the manner in which they create a dynamic for change- the new evolving from the old.

Since the concept of mutuality exists within a particular historical period it will display characteristics that describe the norms of that period. And, when the societal context evolves historically as a response to the conflicting relationships within the whole, so the concept of mutuality contained within the whole also evolves.

As this thesis has demonstrated, the concept of mutuality that emerged within early building societies expressed the norms of that particular context. Early 'terminating societies' were organized as a collective of working people for the purpose of saving for, and purchasing, housing or land. Both the imperative and the ability of these individuals to engage in such an activity resulted from the rapid replacement of the agricultural economy by the commodity-market economy. This had the effect of creating a workforce that was neither tied to the land by feudal relations of production nor possessed the, albeit meager, protection afforded by a feudal hierarchy. Their labour was their property, saleable for a wage; they possessed nothing else. In addition to and complimentary to this, the market economy had the effect of transforming land into a saleable commodity. In this context the commodity, 'wage', could be exchanged for the commodity, 'property'. However, as the early market economy of the eighteenth and early nineteenth century was labour intensive, employers, (supported by the state) were keen to keep wages low. In this period, characterized by Marx as a period of absolute surplus value (ASV), profit could be increased without the need to introduce additional capital (such as machinery) into the productive process. Instead, profit could be increased by directly targeting labour by such methods as, increasing the working day and/or by reducing wages. As this thesis has indicated, the government of the late eighteenth and early nineteenth century placed great political and legislative emphasis on the control of working people. The resulting poor working conditions, low wages and lack of social welfare were all potential causes of unrest and social disorder, and the government feared working class militancy from all directions. It responded with an anti-collective policy and a raft of legislation designed to punish the slightest hint of insurrection.

In this context, and as an antidote to low wages, poor housing and high rents building societies emerged within working communities and were organized and initiated by working people. Building societies facilitated the purchase of housing by collective savings, for those who were too poor to purchase property as an individual but wealthy enough to have something remaining from their wages to save.[1] And, in this context, mutuality reflected the norms of collectivity- equality of responsibility and equality of benefit. All members of such societies were both members and borrowers, and all were members with the same ultimate object, to purchase a home. Thus, once this object had been achieved for all members, the society ceased to have a purpose and would itself cease to exist-hence they were known as 'terminating societies'.

[1] The monthly subscriptions, as previously noted in chapter 2, being relatively high.

This thesis went on to demonstrate that within the historically evolving economic and political context of the nineteenth century, mutuality underwent huge material changes. Firstly, the Reform Act of 1832 introduced a comprehensive and less onerous property franchise requirement. This provided an opportunity to gain the vote through ownership of a portion of property and as a result the popularity of building societies greatly increased, particularly in the context of the freeholdland movement initiated by James Taylor. Secondly, the broad spectrum of those who supported free trade, a policy that crystallized around the anti corn law campaign, saw that their own self interest could be served by giving the financial support to freeholdland societies that would (hopefully) ensure the vote of the newly enfranchised. This further increased the popularity, number and size of building societies.

The organizational form of the terminating society was put under considerable strain by the hundreds of thousands of individuals that had joined building societies by the mid nineteenth century. As a response to this, the 'permanent society' evolved in a form that would facilitate a large and fluctuating membership, a shift that would have a profound effect on the nature of mutuality. The permanent society had perpetual succession-an independent existence from its membership, so when the nature of the permanent society was consolidated in the 1874 Building Societies Act it was understood as designating an incorporated entity. Thus, whilst the terminating society was made up and composed of its membership, the permanent society was a legally distinct entity that acted as a financial broker between the saver members and the borrower members. Mutuality was therefore reconceptualised as designating an internal trading relationship or an entity that traded with itself, whilst continuing the practice of one member one vote. It no longer designated equality of reward and responsibility between members. Furthermore, the permanent societies' reliance on investors, who might have no stake as a borrower, meant that legislative controls were sought to ensure the security of the lender-members' investments. Significantly, this put borrower members under scrutiny and led to building societies introducing rigid lending criteria with a borrower profile that excluded all but white middle class men. In addition to this, capital reserves designed to protect investors[2], created a fund that could and would be used by ambitious building society directors in order to effect a demutualisation or conversion.

This thesis had shown that in addition to the internal organizational demands on societies causing a change in the nature of mutuality, much of the conceptualisation of mutuality, from the 1870's onward was constructed by government policy. The 1874 Act determined that all new societies should be organised under the permanent form and gave statutory authority to its structure and to those that monitored its structure. With this, building societies ceased to be private arrangements and instead became public institutions.[3] Having designated societies thus, government policy increasingly determined their orientation, tending to maintain them as quasi-public financial institutions for the *industrious poor*. So, as this thesis has submitted, the mutual society was unique among commercial institutions in collecting additional controls over its activities throughout a historical period of liberalisation or *laissez-faire*. When compared to the commercial form of the company, government policy toward building societies is plainly revealed. In terms of statutory developments, shareholders enjoyed limited liability from 1855[4] onwards and allowed a company to restructure its capital from 1867.[5] The laxity given to corporate activities by the judiciary in areas such as legal personality[6] and *ultra vires* were not redressed by statute and tended to reflect government's *laissez-faire* attitude to business. In contrast, building society objects were carefully prescribed by statute and the prudential framework placed a higher level of care on the directors of building societies than those expected of company directors.

Government policy, however, was only part of the picture. The conservative nature of building society activities was also due to factors internal to the building society movement itself. For, as chapter 2 evidenced, early building societies had ensured their insulation from the government's

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[2] 1981 Building Societies (Authorisation) Regulations required 2.5% of assets to be held as reserves.
[3] The 1836 Building Societies Act was far too brief and obscure to have designated building society organisation and the nature of mutuality.
[4] Limited Liability Act 1855
[5] Companies Act 1867
[6] Salomon v Salomon [1897] AC 57

draconian anti-collectives policies by adhering to strict internal controls and a non- provocative attitude.

As this thesis has endeavoured to demonstrate, the relationship between factors internal to the building society movement and factors external to it, led to the emergence of demutualisations. Externally, the legislative facility to demutualise was introduced by a famously neo-liberal administration in the form of the 1986 Building Societies Act.[7] However, as this thesis suggests, it would be a mistake to understand this piece of legislation as just another Thatcherite ploy to introduce the free market into all areas of society, although there are, of course, shades of this. In the main, this legislation introduced many opportunities for building societies to be more competitive *whilst retaining* mutual status. Indeed, the small portion of this Act which referred to conversion, required complex procedures and a large proportion of voting, pro-conversion members; more indicative of curtailing rather than encouraging conversions. Furthermore, the demutualisation of over 80% of the building society sector could not have occurred without the enthusiastic activity of both directors and members. As societies operated on a 'one member one vote' basis, it is submitted that, notwithstanding the free market facility encompassed in the 1986 Act, conversion would not have been possible without the active consent of a substantial proportion of a society's membership. And, as chapter 5 indicates, motions to convert have for the most part received the overwhelming support of the membership.

However, what is also evident is the effectiveness of a aggressively pro-conversion management, particularly evidenced in the first ground-breaking demutualisation of the Abbey National. This, coupled with judicial decisions which signified an unwillingness to tamper with the provisions of a particular conversion, created an environment where demutualisation would seem the obvious choice for all players and where only affirmative action could preserve mutuality. This action could not be taken in the 1980's as both Labour and Conservative Parties were critical of building society activities and both sought appropriate market reform. Furthermore, the larger societies, particularly the Abbey National, under Peter Birch, sought the legal freedoms (and financial

[7] Furthermore, the BSA was part of the consultation process and produced the Spalding Report.

rewards) provided by the legal form of an incorporated company. Finally, the membership of building societies did not understand or experience a benefit from mutual status and therefore could not be expected to vote in favour of its preservation if the alternative was a cash reward.

The nature of mutuality had undergone changes throughout the twentieth century that had removed the membership from any possible exercise of control. As this thesis has demonstrated, the permanent system required both managerial and actuarial expertise, shifting control from the membership to a professional elite. In addition to this, the permanent system accommodated large numbers of members which diluted the voting power of one individual member. Furthermore, and as Table A in chapter 3 indicates, the numerous amalgamations of building societies at the end of the nineteenth century led to a ten-fold decrease in the number of societies in existence *per se*, whilst the numbers of members involved with societies continued to increase. As chapter 3 shows the centralization of funds under the ambit of a few building societies inevitably led to a centralisation of power over societies' decision making regarding activities and policies; a tendency that was exacerbated by the advisory role undertaken by the Building Society Association. In this context, mutuality no longer denoted equality, member involvement and mutual reliance but, instead, indicated a method of organizing finance whereby the society effectively traded with itself. The structure provided by the permanent system facilitated this reconceptualisation and the economic tendency toward the centralization of finance took the permanent system to its logical conclusion. Mutuality under this form provided little impetus for the membership to actively seek its preservation.

From that point, the thesis proceeded to assess the factors that could give rise to the preservation of mutuality. It indicated that the activities of a pro-mutuality board could persuade a society's membership to vote against a conversion, amply evidenced by the successful pro-mutuality activities of the Nationwide Building Society. Likewise, it is equally clear that a pro-conversion management can affect the wishes of new investor borrowers (who have less of a financial stake in the society and therefore more to gain from a conversion) notwithstanding the ambivalence of many of its borrowing members, as evidenced in the Bradford and Bingley conversion. The empirical data suggested that better informed members were more likely to want to preserve mutuality. Thus, it is likely that the articulate, pro-mutuality position of a number of chief executives interviewed, particularly those from small local societies, would be effective in retaining the mutual status of their building society. However, as this thesis indicates, it is unlikely that mutuality will be retained as a significant method of organising financial business without the material support of government, which, under the present administration is not forthcoming.

New Labour's 'third way' politics attempt to incorporate the norms of a market economy, albeit one based on service rather than manufacture, with the humanist concerns of socialism. But, as the latter is ideological and the former is structural, it is the former that prevails. Whilst New Labour may identify social problems, such as financial exclusion, it is unwilling to create or even support an organizational method for combating it. In the absence of a material commitment it is left with only the rhetoric of humanism, a rhetoric that stands in stark contrast to the reality of the market. Far from creating new institutions for a new economy, it merely oversees the destruction of old institutions that could still play a part in tackling social problems.

And, whilst New Labour is willing to enjoin building societies to help combat financial exclusion, it is unwilling to protect the organisational status of mutuality, despite the building society executives' insistence that it is mutuality and mutuality alone that enables them to fight financial exclusion. It is more in line with 'third way' politics to prefer market demand for demutualisations above protective measures to preserve mutuality. However, a lingering attachment to social concerns forces New Labour to compensate for its lack of real commitment to equality by creating new concepts. Thus mutuality is reconceptualised as 'new mutualism', an essentially meaningless phrase that urges ethical business practice without making that practice possible.

The thesis has indicated the legislative activity of New Labour has further undermined the distinct identity of mutuality. We have seen that in the regulation of building society activities, the FSA retains huge powers, including the right to modify and develop its rules in order to regulate all imaginable future activities. And, as it is a method of regulation that is applicable to all 'persons' who are engaged in the many 'controlled functions' outlined above, (that is all those in the financial services sector), mutual societies do not have an individualised system of regulation. Given the demise of the function of the chief registrar, they have no regulator assigned to mutual building societies alone. All functions previously performed by the registrar are now performed by the FSA and all relevant parts of the Building Society Act 1986 have been repealed accordingly.

This homogenization of regulation signals a continued lack of political will to preserve mutuality that, in today's climate, requires definitive action. As this thesis has demonstrated, mutuality emerged organically as a material description of the relationships between members of a collective. The popularity of building societies necessitated a new organizational form that diminished the original equality of mutuality, creating three legal beings, the borrower, the saver and the incorporated building society. From the period following the 1874 Building Societies Act, government has maintained a central role in both the construction and destruction of mutuality. The former by introducing favourable commercial structures given on condition that building societies performed more restricted commercial activities, the latter by introducing legislation permitting conversion.

In the twenty-first century, it is still government that can choose to preserve mutuality. Ironically, New Labour, a government wedded to the language of mutuality- the social coupled with the commercial- will not do so. Perhaps the final irony in the history of mutuality will be its fate returning into the hands of its membership. The hypothesis that demutualisations or conversions may be understood as resulting from the historical reconceptualisation of mutuality has been proven. It remains to be seen if future government activity will reconstruct mutuality in a manner that precludes its annihilation.

Appendix 1

The Statements of Principle

Statement of Principle 1

"An approved person must act with integrity in carrying out his controlled function."

Statement of Principle 2 pertaining to behaviour

"An approved person must act with due skill, care and diligence in carrying out his controlled function."

Statement of Principle 3

"An approved person must observe proper standards of market conduct in carrying out his controlled function"

According to the FSA in many cases the required standards are set out in Inter-Professional Conduct and the Code of Practice of Market Conduct.[8]

Statement of Principle 4

"An approved person must deal with the FSA and other regulators in an open and co operative way and must disclose appropriately any information of which the FSA would reasonably expect notice."

Statement of Principle 5

"An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible is organised so that it can be controlled effectively."

Statement of Principle 6

"An approved person performing a significant influence function must exercise due skill, care and diligence in managing the business of the firm for which he is responsible in his controlled function"

Statement of Principle 7

"An approved person performing a significant influence function must take reasonable steps to ensure that the business of the firm for which he is responsible in his controlled function complies with the relevant requirements and standards of the regulatory system."

Appendix 2

STREET SURVEY 1997 & 2000

1 Are you a member of a building society?

a. no - proceed as normal but ask 4(b)

b. yes - proceed as normal but ask question 4(a)

2 Have you heard of the term mutuality, demutualisation or mutual status in the context of building societies?

a. no - explain term and proceed to question 4.

b. yes - proceed as normal

3. What do you understand by this term?

4. (a) If answer to question 1 was 'yes, I am a member of a building society' then ask, "has your society voted on the issue of becoming a plc?"
(i) If the answer is 'yes, my building has voted to become a plc', then ask "How did you vote?"
1. Voted in favour.
2. Voted against.
3. Did not vote.

4. (a) (ii) If the answer is 'no, my building society has not voted on the issue of becoming a plc', then ask "If your Building Society proposed becoming a plc how would you vote?"
1. In favour of becoming a plc
2. Against becoming a plc
3. Would not vote

4. (b) If answer to question 1 was 'no, I am not a member of a building society' then ask "If you were a member how would you vote?"
1. In favour of becoming a plc
2. Against becoming a plc
3. Would not vote.

5. Do you think that organisations with mutual status are worth preserving?

6. Why do you think that?

Appendix 3

Interview questions: ATTITUDES OF CHIEF EXECUTIVES*

1. How long have you worked in mutual societies?

2. How would you define mutuality?

3. Do you think that shareholders could have anything positive to contribute to your organization if you demutualised?

4. Would you personally stand to profit if your society were to demutualise?

5. Do you think that the demutualisation of other societies has been member or manager led?

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* These interviews were undertaken at the BSA conference 1999

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